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GOVERNMENT FURNISHED PROPERTY PROVIDED TO DOD CONTRACTORS

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

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GOVERNMENT FURNISHED PROPERTY PROVIDED TO DOD CONTRACTORS

MONDAY, MARCH 21, 1988

U.S. Senate,
Committee on Governmental Affairs,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m., in room SD-342, Dirksen Senate Office Building, Hon. John Glenn, Chairman of the Committee, presiding.

Present: Senator Glenn.

OPENING STATEMENT OF CHAIRMAN GLENN

Chairman Glenn. The hearing will be in order.

Before we start today's hearing I would like to acknowledge the presence of some very distinguished guests in the audience this morning from Ireland: The Chairman of the Public Accounts Committee of the Irish Parliament, Gay Mitchell; Deputy Noel Dempsey; Deputy Liam Naughten; the Irish Comptroller and Auditor General, Lauri McDonnell; and his Deputy Director, John Purcell.

If you gentlemen would stand, we would appreciate it this morning. Glad to have you with us. Thank you.

They are in many respects our counterparts in the Irish Government, so we particularly welcome their presence this morning and look forward to having them with us.

This morning's hearing on Government furnished property is one of a series of hearings that we have been having. The first one involved the big picture, if you will, in some of these areas. The chart over here shows the growth in the Approved Force Acquisition Objective.[1]

The orange figures are the long supply figures, if you cannot read the print from way back there. Long supply is what the Pentagon terms the materials for which there is no need now or no known need in the future.

In other words, these are either acquisitions that should never have been made to begin with or were not able to be cancelled during the term of a contract or a number of reasons. But the basic point for displaying the chart and discussing what our previous hearing showed was that that long supply has grown tremendously since 1980.

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[1] See chart on p. 198.

It has gone from $10 billion of unneeded supplies up to $30 billion at the end of 1986; $30 billion. Those are not millions; $30 billion.

So we have had a $20 billion increase over that 6 year period in long supply items. In other words, items that basically are waste. There is always going to be some changing in requirements, I know that. But I just don't see that it should be anywhere near that amount.

Today we are investigating supply problems related to Government furnished property. We are looking into hidden costs that are waste, fraud, and abuse.

Let me add that there have been many GAO reports on Government furnished property over the past 20 years or so. This is not something that just goes back to 1980. It goes way on back before that.

We have just seen a huge increase in Government furnished property since 1980 during the defense buildup years. There have been dozens of reports and nothing much seems to have been done about it. That is the reason we want to bring attention to it now.

I have a longer statement that has been released at the press table, and I will give a shortened version as an opening statement for today's hearing.

We are going to review a serious and long standing problem regarding the furnishing of Government property, free of charge to defense contractors. Until recently DOD did not even know the value of Government furnished property it had given to defense contractors. But DOD now reports that its contractors have at least $51 billion in Government property.

Now, I recognize fully that often there are very good reasons to provide Government property to contractors and that such an arrangement can be cost efficient. Many years ago when I had just ceased being a test pilot, I was put on duty in Washington in the old Bureau of Aeronautics building. Part of our procurement duties came under my office, and we had Government furnished equipment back at that time.

An example of that equipment is altimeters that are to be standard in every aircraft. The Government can provide those from one source, do it on a bulk purchase basis, furnish it to the production contractor, and save money. Now, I don't quarrel with that whatsoever. We provide in some cases engines or we provide parts that are of a specified, standardized nature for things such aircraft and tanks. But it often does not make sense to provide Government furnished property to service contracts or to operation and maintenance contracts, unless the reason for doing it is written right into the contract. That is usually not the case.

Now, $51 billion in Government furnished property is an enormous amount of money, and we need to make sure that every one of these $51 billion is well spent. Unfortunately we have information to indicate that some of that money is being wasted, or worse. Our control systems are so inadequate that we cannot even tell if abuses are occurring.

So I begin this hearing by asking three very fundamental questions. First, why do defense contractors have so much Government furnished property when the policy of the Government is that contractors, not DOD, are generally responsible for providing the property necessary to perform Government contracts?

Second, does DOD have adequate assurance that Government property provided to contractors is being used for its intended purposes?

And third, why has DOD been unable to correct to longstanding problems regarding Government furnished property?

GAO, as well as DOD audit agencies, have been issuing reports on deficiencies in providing Government property to contractors for about 20 years. In essence, the auditors believe, one, far too much Government property is being provided to contractors.

Second, DOD's systems do not permit us to know if the property is being diverted, and third, while some corrective actions have been taken, there is little evidence that had basic problems are being corrected.

We will discuss four examples this morning that demonstrate some of the problems inherent in the provision of Government furnished property. Let me highlight two of them here and include the full text of all four in my longer prepared statement.

Today we will hear for the first time the preliminary results of an audit concerning the provision of Government furnished equipment to providers of analysis and intellectual services, sometimes called here in Washington, rightly or wrongly, the beltway bandits because of their proximity to the Pentagon and the capitol beltway.

The equipment involved is euphemistically called, "other plant equipment," OPE, by DOD, which translates to such things as desks and typewriters, television sets, computers, and vehicles. As of September 30th, 1985 in the Washington area, 77 DOD consulting-type contractors had a total OPE inventory of $115 million.

The DOD Inspector General sampled 15 contractors with some $25.4 million of this OPE. The contractors, sometimes with specific DOD approval and sometimes without, purchased the equipment they wanted, billed DOD for it, and were reimbursed by DOD.

Incredibly, 8 of the 15 contractors charged a fee above the purchase price and were paid for it even though payment of such fees is completely improper for this type of contract.

One contractor, for instance, received $12,300 in unallowable fees for acquiring $196,300 of OPE in 1986. Another received $6,100 in unallowable fees for acquiring $75,000 of OPE in 1986. Six of the 15 contractors sampled charged the Department of Defense for OPE purchases without specific contractual authorization.

In fact one contract clause precluded provision of the equipment stating, "All other material required in the performance of the contract shall be furnished by the contractor."

A contractor representative interpreted this clause to provide authority to acquire and change OPE to the contract. It is little wonder the title of beltway bandits has been applied to some of these items. I don't mean to castigate everybody by that because there are a lot of fine firms doing very good and conscientious work for the Government.

Where we see cases like this coming up, I think the title beltway bandits has some meaning to it.

But it is even more wonder to me that no one in DOD challenged these purchases and fees, and they were paid contrary to policy.

The truth is these contractors should supply their own equipment unless there are very good reasons not to do so, and these reasons are properly stated in the contract.

Unfortunately, it appears that DOD has given these contractors what we could term a special gold credit card to rip off the U.S. taxpayer. DOD has created a situation that is wide open for fraud, waste, abuse and we are fortunate that the DOD Inspector General has challenged this abuse.

I would say this morning, this situation must be changed by DOD management, and be changed immediately. If it becomes necessary to introduce legislation to better protect the taxpayers' interests, I will certainly do so.

Here is another example. During 1986 the Naval Audit Service, NAS, reviewed the Navy's management of Government furnished material such as avionics, engines, and tires being held by several Government contractors, one of which was Grumman, which builds a number of different types of Navy aircraft.

NAS reported that of $336 million in Government furnished material held by Grumman, $114 million was being retained under physically completed contracts or contracts under which all aircraft had been delivered. An additional $7 million was being held even though there had been no demand for the material for over 12 months.

I'm not implying that Grumman was necessarily at fault in this any more than the Government was for providing the material that just sat there. The implication is that $121 million in unneeded material may have been unnecessarily ordered, provided and retained. The only dispute is over how much of this total was unneeded.

Also, items needed by the Navy supply system for use by the Fleet sometimes sit on the shelves at Grumman or other contractors, while it may be needed some place else. This happens because we don't even know for sure how much is at the various contractors.

While in extraordinary circumstances the Navy supply system can obtain items held by the contractor, generally the Navy doesn't know what items Grumman even has in its inventory. In fact, the Navy has no way of verifying from its own records what the contractor has obtained free of charge from the DOD supply system.

We will hear testimony this morning which indicates that the Grumman situation is not atypical. These two examples are indicative of systemic problems that need and must have corrective actions. These actions are necessary.

First, the FAR, the Federal Acquisition Regulation, needs to be clarified to insure that DOD procurement personnel understand that contractors, not DOD, are to provide the property necessary to complete Government contracts.

That's particularly true for service contracts and maintenance contracts, in which much of the Government furnished material is consumable and readily available from the commercial marketplace.

Second, when an exception is made to the policy and property is provided, a specific written justification and to the extent possible, a listing of the property to be provided should be included in the contract.

Third, DOD needs to reconsider the requirement that contractors maintain the official and only inventory record for Government furnished property.

This is a little bit like a situation in which I owned a building supply company here in the Washington area. My company could supply everything you would need to build a house. I decided to contract with some builders to build five houses for me.

Now, I tell these builders I will supply all the material they need to build the houses. But, I don't even inventory what they take out. They drive truck after truck up to the warehouse. They take lumber, bricks, mortar, door hinges, doors, pipe, everything that goes into building five homes. And I don't even check what they have.

Occasionally I call the contractors, and I say, how is your inventory coming over there? What do you have in stock? I leave it completely up to them to tell me what they have. I don't even check it.

Now, we would think that was the most ludicrous business situation that we could possibly imagine, and it would be. Yet that is in effect what we are doing with our Government contracts too many times. So an accommodation needs to be made so that DOD has the where with all to know what Government furnished property contractors are receiving and what they have on hand. And finally, steps need to be taken to strengthen DOD's property administration function.

I have one more example to discuss. In our previous hearing, I mentioned that when Navy material is sent to contractors for overhaul the Navy relies on the contractors to keep a list of what they have. The Navy doesn't even keep an accurate inventory of items sent to contractors for overhaul. When the Navy wants to update its records they call the contractor and say, how many items do you have that are being overhauled right now? The figure comes back from the contractor and is entered into the Navy records as the official inventory of what is at that contractor's facility.

Now, that gets to be a little bit ridiculous, quite obviously. I asked what is to prevent the contractor from siphoning off some of the Navy equipment, or dishonest people out there taking some of the Navy equipment. They said, well, we have approved this particular contractor's accounting system, or we do not do business with him. That was the justification.

My question to the Navy was, let's say I have so many instruments arriving at the contractor's loading dock. How do they get checked in? They said the instruments would be checked in by the company. I said, what if you have a dishonest person on the loading dock that siphons off a third of these instruments into another truck and drives off with them? What is to prevent that? The answer was, we do not think that would ever happen.

I hope they are right. But I think we need a better system than that.

We are pleased to have the hearing this morning. We think the hearing involves some issues, obviously, which I feel are very important.

[The prepared statement of Senator Glenn follows:]

PREPARED STATEMENT OF SENATOR GLENN

Today the governmental affairs committee will begin a review of a serious and longstanding problem regarding the furnishing of Government property free of charge to defense contractors. Until recently, DOD did not even know the value of Government furnished property it had given to defense contractors. DOD now has reports that contractors have at least $51 billion of Government property as of September 30, 1987. I recognize that often there are good reasons to provide Government property to contractors and that such an arrangement can be cost efficient. But $51 billion is an enormous amount of money, and we need to make sure every one of those dollars is well spent. Unfortunately, we have information to indicate that money is being wasted—or worse—our control systems are so inadequate we can't even tell if abuses are occurring.

I begin this hearing by asking three fundamental questions. First, why do defense contractors have so much Government furnished property when the policy of the Government is that contractors, not DOD, are generally responsible for providing the property necessary to perform Government contracts? Second, does DOD have adequate assurance that Government property provided to contractors is being used for its intended purpose? Third, why has DOD been unable to correct the longstanding problems regarding Government furnished property?

I have four examples to discuss which demonstrate some of the problems inherent in the provision of Government furnished property.

INTELLECTUAL SERVICE PROVIDERS: A SERVICE CONTRACT

Today we will hear for the first time the preliminary results of an audit concerning the provision of Government furnished equipment to providers and analysis and intellectual services, sometimes called "beltway bandits" because of their proximity to the Pentagon and the Capitol beltway. The equipment involved is euphemistically called *"other plant equipment"* (OPE) by DOD, which in common language means items of equipment such as office furniture, computers, television sets, and vehicles. As of September 30, 1985, in the Washington area, 77 DOD consulting-type contractors had a total OPE inventory of $115 million. The DOD-IG sampled 15 contractors with $25.4 million of the OPE. The contractors, sometimes with specific DOD approval and sometimes without, purchased the equipment they wanted, billed DOD and were "reimbursed" by DOD. Incredibly, 8 of the 15 contractors charged a FEE above the purchase price and were paid for it even though payment of such fees is completely improper for this type of contract. One contractor received $12,300 in unallowable fees for acquiring $196,300 of OPE in 1986. Another received $6,100 in unallowable fees for acquiring $75,000 of OPE in 1986. Six of the 15 contractors sampled charged the DOD for OPE purchases without specific contractual authorization. In fact, one contract clause precluded provision of the equipment stating: "All other material required in the performance of the contract shall be furnished by the contractor." A contractor representative interpreted this clause to provide authority to acquire and charge OPE to the contract.

No one in DOD challenged these purchases and fees, and they were paid contrary to policy. The truth is these beltway bandits should supply their own equipment. Unfortunately, it appears that DOD has given these contractors a special gold credit card to rip off the U.S. taxpayer. DOD has created a situation that is wide open for fraud, waste, and abuse, and we are lucky that DOD inspector general has challenged the abuse. This situation will be changed by DOD management or, if necessary, I will do it by legislation.

NAVAL AIRCRAFT PRODUCTION PROBLEMS

During 1986, the Naval Audit Service (NAS) reviewed the Navy's management of Government furnished material, such as avionics, engines, and tires, being held by several Government contractors, including Grumman which builds a number of Navy aircraft. NAS reported that of $336 million in Government furnished material held by Grumman, $114 million was being retained under physically completed contracts or contracts on which all aircraft had been delivered. An additional $7 million was being held even though there had been no demand for the material for over 12 months. As a result, the Government may have incurred unnecessary storage costs, and up to $121 million in unneeded material may have been unnecessarily ordered and retained. The only dispute is over how much of this total is unneeded. Also, items needed by the Navy supply system for use by the fleet, sometimes sat on the shelves at Grumman. While in extraordinary circumstances the Navy supply system can obtain such items held by the contractors, generally the Navy doesn't know what items Grumman has in its inventory. In fact, the Navy has no way of verifying from its own records what the contractors had obtained free of charge from the DOD supply system. We will hear testimony this morning which indicates that the Grumman situation is not atypical.

EGLIN AIR FORCE BASE: AN OPERATIONAL MAINTENANCE SERVICE CONTRACT

The armament division at Eglin Air Force Base granted an award fee contract for the operation of the base test range. Although there was no written justification for providing GFM to the contractor, the Air Force provided millions of dollars of material free of charge whenever the contractor requested it, including commercially available items. The materials involved in this example, for the most part, are consumable materials such as paint, small hardware items, and photographic film. The contractor, with Air Force approval, had his own supply warehouse, within a mile of Eglin base supply from which he drew these supplies. The contractors, in effect, duplicated the Air Force supply system by maintaining a 60-day supply of stock. If our supply system can provide materials to keep Air Force planes flying, presumably there was no reason to have two separate systems side-by-side.

Although base supply personnel reviewed contractor material requisitions for accuracy, no one reviewed the requisitions to verify that the material and quantities ordered were necessary to perform the contract. During fiscal year 1986, $5.6 million of GFM was provided to the contractor. GAO sampled the items in the contractor's warehouse and found that 42 percent of the items reviewed had no activity for 1½ years, and 33 percent had no activity for at least 3 years. This is what DOD calls "long supply", a euphemism for goods procured when they are not needed. The contractor received a poor rating from the Air Force for its property control system, but it still received an overall contract rating of excellent and was granted an award fee of over $430,000 which was 95 percent of the available award fee. It is obvious that property control carried little weight in determining the award fee.

This example and others like it demonstrate the foolhardiness of our current policies and their implementation. If you or I owned a building supply business and hired a contractor to build a house, you might tell the contractor that you could provide all the materials he needs and give him access to your supplies. But you would never do it without controlling his access. You would never advise him that you do not have the time or inclination to know what he is taking. What a temptation DOD has created in its system. It certainly takes away the contractors's incentive to economize in using the materials. It also creates temptations to divert material for other uses.

NAVY REPAIR ITEMS: REPAIRABLE SERVICE CONTRACTS

The Navy has a serious problem in accounting for and controlling items which are sent for repair to contractor plants and other military services' repair centers. The Navy maintained financial records concerning these items, but the contractors were responsible for maintaining the "official" inventory record.

The Ships Parts Control Center admitted in letters sent to contractors and other military repair centers that it had no accountability or control over the center's repairable items in these non-Navy facilities. The center asked the contractors and other military services to provide the Navy with the necessary information as to what Navy-owned items were at their facilities for repair. (An analogy would be a situation where your bank says we don't remember how much we loaned you and asks you to provide the information.) As a result of the information received, the Center adjusted its financial records by $620 million and suffered a net loss of $464 million, with no real assurance that such adjustments were accurate.

In the worst case, one single contractor reported that it had over $48 million less in repair items than the Navy's information indicated. However, the Navy did not, and said it could not, reconcile the difference in the figures because of the poor to non-existent quality of the Navy's records. The Navy chose not to audit the contractors in question before writing off the material, including those contractors where the disparity was particularly large.

GAO, as well as DOD audit agencies, have been issuing reports on this area for about 20 years. While some corrective actions have been taken, I have seen little evidence that the basic problems are being corrected. At the request of Senator Pete Wilson and myself, the GAO has just completed a series of specific studies in which they concentrated on the problems or providing GFM to defense contractors, primarily contractors performing maintenance work.

Before we hear from our distinguished witnesses, I'd like to sum up some of the key problems in providing Government furnished property, particularly GFM and OPE:

Despite Government policy to the contrary, DOD routinely provides GFM and OPE free of charge to contractors on the blind belief that it is in the Government's best interest to do so. This occurs without any analysis or written justification to support their contention.

To enable contractors to easily obtain GFM, DOD allows contractors to requisition the materials, using standard DOD procedures, either directly from the DOD wholesale supply system or from military base supply activities. However, there are few, if any, controls to ensure that the contractors requisition only the GFM needed to accomplish their contracts.

Once material is issued to a contractor, GFM is generally dropped from DOD's inventory records, and the contractor becomes responsible for the material in its possession. However, DOD's property administration system is not adequate to ensure that (1) the contractor has only requisitioned and received needed material, (2) the material is properly stored and secured, and (3) The material is used on the DOD contract for which it was requisitioned.

To correct these longstanding problems, I believe the following actions are necessary.

First, the Federal Acquisition Regulation needs to be clarified to ensure that DOD procurement personnel understand that contractors, not DOD, are to provide the property necessary to complete Government contracts. Second, when an exception is made to the policy and property is provided, a specific written justification and, to the extent possible, a listing of the property to be provided should be included in the contract. Third, DOD needs to reconsider the requirement that contractors maintain the official and only inventory record for Government furnished property—an accommodation needs to be made so that DOD has the where-with-all to know what government furnished property contractors are receiving and what they have on hand. Finally, steps need to be taken to strengthen DOD's property administration function.

Senator GLENN. Senator Sasser has asked that his statement be included in the record also.

[The opening statement of Senator Sasser follows:]

OPENING STATEMENT OF SENATOR SASSER

Mr. Chairman, I'm pleased to be here today to look into an important management issue: The matter of the Department of Defense providing of Government property to defense contractors. I commend the distinguished chairman for delving headlong into such an important and complex matter as accounting for DOD inventory. As my colleagues and others in this room know, we have begun to approach the problem of our enormous Federal deficit with a new seriousness. DOD contractors have an estimated 51 billion of dollars worth of DOD property for which DOD cannot fully account. Looking more closely at matters like this is a good way to start trimming budget waste.

Many aspects of DOD's manner of managing government owned inventory result in a chaotic system—or rather "non-system" in which DOD must rely on contractors to provide information on what types, what amounts and the value of the property the contractor has received from DOD. DOD's "non-system", in many cases, permits contractors to acquire property and equiment—usually free of charge that the contractor will not need or use. DOD then drops those items from DOD inventory records, so there is a good chance that the contractors will not have to account for these properties—Federal Government properties.

It would seem that tighter accounting and controls are certainly needed. The General Accounting Office has done some excellent work on this matter over the years. I look forward to hearing the testimony today. We must find ways to address this accounting problem.

Chairman GLENN. Our first witness this morning is Mr. Derek J. Vander Schaaf, Deputy Inspector General, the Office of the Department of Defense Inspector General.

Mr. Vander Schaaf, we welcome you this morning. Please give your full statement or an abridged version, whichever you see fit to give. In any event the entire statement will be included in the record.[1]

TESTIMONY OF DEREK J. VANDER SCHAAF, DEPUTY INSPECTOR GENERAL, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. VANDER SCHAAF. Thank you, Mr. Chairman.

I would like to summarize my formal statement by going through it and discussing some of the highlights.

I welcome your interest in this area. I have been involved in it one way or another for some 20 years myself. I believe the concerns you just expressed in your opening statement are very well placed. We have recognized this problem for decades. There is simply just too much property being furnished unnecessarily to our contractors.

The policy is the Department of Defense generally will not provide property to our contractors. When we do, it is supposed to be an exception. The fact of the matter is the exceptions to the policy have become the prevailing practice.

In 1970, DOD initiated a policy to phase out over 5 years all Government owned facilities in possession of contractors. This effort was called a phase-down policy, but since that time the dollar value of property being furnished has continued to increase.

In 1985 there was an estimated $10 billion worth of this property in contractors' hands. At that time the Department got serious about trying to count it all. By 1986 we had attempted to count all the equipment and had reached $45.2 billion.

Last September we topped it off, as you mentioned, at $51.3 billion. I hope that that has now reached its peak and we will see some decline as we begin to focus attention on this issue.

Again, as you mentioned, Mr. Chairman, there are a number of IG reports, General Accounting Office reports, and Military Department audit reports on this matter.

Let me just briefly highlight some of the specific problems that we have encountered. One is that there continue to be purchases of this equipment without any contractual authorization on the part of the Government. Often times the contractors have failed to report equipment that they purchased and then to declare this equipment excess. Special tooling and special test equipment has been a particularly grievous area. We have also incurred unnecessary storage costs. Many times, in my opinion, we have incurred unnecessary costs in the purchase of special test equipment.

Much of that special test equipment is nothing more than commercially available products, primarily ADP type equipment, which when hooked together becomes special. We pay and expense the full value of that equipment on each contract where it is required.

We have found that contractors have earned unallowable profits by charging the Government when they have purchased this kind of equipment for their facilities. As I have mentioned, they have not taken timely action to dispose of the problem.

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[1] See p. 49.

One additional new problem area that has arisen in recent years, at least in the last year or two, is in the area of material management accounting systems, also referred to as material requirements planning systems. Contractors use these systems to support the production process.

We have done some audit work in this area and have found that the transfer of products between the commercial contracts and Government contracts is not closely controlled, nor are the costs that are attached to these products closely controlled.

Mr. Chairman, you mentioned in some detail the recent audit we did on the administration of the Other Plant and Equipment in the Washington, D.C. area. I will not stress that much further, except to say that the items that were covered in that audit included a lot of office furniture, computer equipment, television sets and so forth.

In 1970, we had $1.9 billion worth of other plant equipment in contractor's possession and the Department of Defense had the policy that it would go to zero dollars in 5 years. Today we have $4.2 billion. So instead of going to zero dollars, we have increased by over $2 billion.

Chairman GLENN. $4.2 billion; was that your figure?

Mr. VANDER SCHAAF. $4.2 billion, yes; yes, I believe about $2.5 billion is the net increase. This audit showed that the controls on other plant equipment in the consulting and study type contracts were just not adequate.

A problem you did not mention is that much of this equipment is expensed within a single contract. It should be depreciated. If we depreciate it we save the time value of money. In addition there is the possibility that the equipment will be used on some commercial work and will be charged to overhead accounts. It will then be allocated in part to commercial work and in part to Government work, rather than being expensed 100 percent to the Government.

Chairman GLENN. Once the Government has bought it under this contract then, can the contractor, after completing the contract just retain the equipment?

Mr. VANDER SCHAAF. Generally speaking, they just retain it. If the contracting officer could find another alternative use for it, he could in fact refer it to another contractor. But what typically happens is the next contractor says, "Well, this is old. I do not want old furnishings," or "I want the latest piece of ADP equipment and this doesn't quite meet my needs."

Obviously, if the contractor knows the Government is eventually going to provide the equipment without much argument, the contractor prevails. We provide new equipment for the next contract in that area.

I'm sure you will have some questions on this business of providing other plant and equipment to contractors in the Washington area. Another issue I want to mention, one that has given us much trouble over the years, involves special tooling and special test equipment. That problem has grown over the years and is currently about $8 billion, about $3.1 billion of special tooling and $4.9 billion of special test equipment.

Again, the Departments simply are not following the Federal Acquisition Regulations in determining whether or not it is advantageous to the Government to buy this type of equipment. Much of it is general purpose components in commercial automated data processing equipment. There is no empirical data or process available to determine whether it is more economical for the Government or the contractor to provide this equipment.

Without some clarification and methodology to be applied on a regular basis, it is going to be extremely difficult for our contract administration officers to know when to provide this kind of equipment, and when not to provide it.

We have also attempted to clarify and to broaden, if you will, the definition of what constitutes STE because of the many difficulties in considering commercial items to be special test equipment.

Actually the FAR change that is under review would reflect what is really happening in the field. However, I think it is going the wrong way because it is clearly contrary to the Under Secretary of Defense's policies which were issued in November, 1986. The policy was to reduce the amount of STE and special tooling in the hands of defense contractors.

We offered the Department of Defense three alternatives with respect to this area and recommended they select one of the following. The responses to date from the Department have been, "We do not support any of your recommendations, Ms. IG."

Here is what we said the Department could do. Don't allow or pay for standard of general purpose ADP as special tooling. Or alternatively, only pay the minor costs of hooking the different ADP components together and then unhooking those components at the end of the contract, rather than paying for all of the components.

What happens now is that the contractor will take a major mainframe computer, hook it to a number of small test computers that are in the facility. Now the contractor can expense that mainframe computer because it is hooked to some small computers in the production process.

The third alternative offered, if the Department does do not like either of those two, was to pay no profit or fee for purchases of general purpose, commercially available items. We are still debating that issue in the Department. I do not know what the final outcome will be. My office is of the opinion that we will probably present that issue to the Secretary of Defense for resolution, if we cannot resolve it at a lower level.

The Committee staff also indicated to us that you were interested in a 1984 IG report entitled "Government Furnished Material at DOD Production Contractors." In that particular review we identified about $25 million of excess GFM at 15 production contractors we looked at.

Our recommendation was that the Department go out and do a one time review of production contractors and find out how much GFM they have. I am happy to report the Department has done that.

Unfortunately, the base that they selected to do it from was set at $20 million. Consequently anyone who had a contract or had property that was assigned against a contract of less than $20 million didn't get reviewed. Also along that line, there was a very comprehensive and good policy memorandum put issued by the Department in November 1986 on this matter. I think that the policy memorandum is starting to have some impact with respect to the amount of GFP in the hands of our production contractors.

Now, the other point, and the final area I think I should touch on before I close and let you ask me some questions. This last item is the financial accounting system for Government property. How does the Government account for property and what should the Government do and what should the contractor do in this area?

First of all, there is a need, in my opinion, for the Government to have some kind of financial accounting control of these systems. I am not convinced that the Government has to have the inventory accounting, if you will, on a detailed basis, that is on exactly where the equipment is located, what model it is, what color it is, and all of the kinds of things that are involved in detailed inventory records. But clearly there is a need for the Government to have a financial accounting system.

This need was brought out by the General Accounting Office back in 1980. It has not gone very far in the Department of Defense to date. There is some question on what would constitute a system that would meet the General Accounting Office standards.

My bottom line is that we need a uniform system on which the Army, Navy and Air Force can agree; one that has some internal controls which will allow us to tie the contractor's property or inventory records to the financial property records that the Government would maintain. To date the Government is not maintaining either of those records.

You suggested in your opening statement that the Government might also want to take control of the inventory records. I am not so sure that that would be cost effective. I think the jury is still out on that, but certainly that also deserves some study.

One other point I should make, Mr. Chairman, before I finish. You briefly brought this up also in your opening statement. It deals with the contractor's access to our supply system.

How does a contractor get Government furnished material as part of the production process? Many of our contractors are given a open allotment, if you will, to request stock fund items from the DOD supply system. Many of these items are very common, everyday items that are routinely available in the commercial marketplace.

I have proposed on a number of occasions that we charge contractors for access to our supply system because we simply do not have the ability to control that access. When the access is made freely available there is no reason or anyone to be tight about what they request.

It is easy to say, well, I may use so many of widget A in a maintenance or repair contract. I am not sure if I am going to have to replace them all, but I will order my total number just in case.

The contractor orders the possible highest number. Then a year and a half later when the contract is finished we find out they used 10 or 15 percent of what they expected to use. In the meantime the DOD supply system took action because the demands were great for this particular item. Somebody else had requested it and the system therefore ordered a lot more.

Now we have a situation where we have a lot of these on the shelves, based upon unused or unreliable demands. We have a contractor with a lot of these in his inventory. We are unable to use any of them and they have to be disposed of.

I think the Navy Auditor General is going to be here later this morning in these hearings and he will talk some more about this issue.

In summary, I want to tell you that my Office will continue its audit, oversight and follow-up on the numerous audit reports that have been issued on the control and management of Government property, both internal to the supply system of the Department, and that which is in the hands of contractors.

We currently are tracking some 47 priority audit recommendations regarding Government property furnished to our contractors. We will monitor those recommendations closely. We will push management to implement those recommendations or provide us good reasons why they are not going to implement them.

That concludes my remarks, Mr. Chairman, and I will try to answer your questions.

Chairman GLENN. Fine. Thank you very much.

We appreciate your remarks and your longer statement will be included in the record in its entirety.

You looked particularly at equipment purchased for contractors in the Washington area. I suppose they were a little easier to get to and monitor, just because of the proximity of offices and so on.

You checked just a few firms. There are other firms all over the country doing business with the Government. Is the situation you found around the beltway a nationwide problem? If so, can you put a dollar figure to it?

Mr. VANDER SCHAAF. Let me start with the back part of the question first. I do not think we can put a dollar amount on it, because there is $4.2 billion of this other plant equipment involved. Of that $4.2 billion how much is in the hands of study and consulting contractors we do not know. If we did, we could probably make some projections based upon our Washington, D.C. area audit.

Obviously, I think that the situation is probably no different in other places such as the Los Angeles or Boston areas where we have many study and consulting type activities financed by the Department of Defense.

Chairman GLENN. I do not want to be unfair about this thing, but do the contracts with companies that have this government furnished equipment state that the Government will furnish the office equipment, the desks, and the TVs.

Mr. VANDER SCHAAF. Yes, there are some contracts with these provisions. I am not sure there are any study and consulting contractors that have such provisions. Clearly other plant equipment is in the contracts of some industrial producers, where GFE include, jigs, dies, molds, other unique measuring devices and so forth. There may be some study and consulting contracts that have this provision.

I know there are some contractors that have a lot of automobiles. Again I am not sure if we have any study and consulting type contractors that are furnished Government automobiles. I would doubt that we have many, but there might be some.

Chairman GLENN. Just from any own experience, I know that in years past these things that were going to be furnished, to my knowledge, were always put right in the contract. However, it is one thing to provide contractors with parts for aircraft, for instance, and it is another thing when we get into such mundane things as paint, and putty and replacement windows and things like that that can be requisitioned from DOD's supply system. Apparently there is no follow-up as to whether the amount requisitioned was proper, whether any excesses were turned back to the Government or not.

As I understand it, for many of these contracts, when the DOD provides material to the contractor, DOD considers the material to be expended and marks it off the books; is that correct?

Mr. VANDER SCHAAF. I would not say that is always the case. That has been the case far too often, unfortunately. I do not know how to quantify it for you. I wish I could. I just cannot do it. Certainly every time we audit we tend to find the kind of problems you are describing.

Chairman GLENN. Who in the Department of Defense is responsible at the operating level for correcting problems with government furnished property, minding the store, if you will, and what is their response to this?

Mr. VANDER SCHAAF. Let me back up just a little bit in trying to answer that question. In 1981 the House Government Operations Committee recommended that we establish within the Department a central office, adequately staffed to take care of this problem. The closest thing we have today is the new Under Secretary of Defense for Acquisition.

Mr. Costello is the current incumbent, and I think he has to take the bull by the horns and force full cooperation from the services. He as to do the things in terms of adequate staffing and adequate training needed to make this process work a little better than it has in the past. So that is a real challenge for Bob Costello.

He is going to be here this morning to talk about this.

Chairman GLENN. How much do time constraints on getting the job done have to do with providing government property? Everyone thinks they have to take the most expeditious route in doing their job. Is this part of the problem? Is it we purchase things in excess to make sure we have enough to do the job we are charged with doing?

Mr. VANDER SCHAAF. That is certainly part of it. The contractors will make an argument that they cannot get equipment in a timely manner, or are unwilling or reluctant to get it. They then say, "Well Government, you can get this kind of item quicker than I can buy it." They will use that argument occasionally. I do not know if that argument is regularly used as, quote, an "excuse" for having the Government furnish items, but it does occur on occasion.

Chairman GLENN. In your own investigations, what kind of justifications, if any were given as to why the consulting contractors were provided so much OPE?

Mr. VANDER SCHAAF. Most of the justifications simply were not there. Contractors just had a general reluctance to do it. They knew that the Government would provide the equipment if they showed reluctance or, quote, some "unwillingness" to provide the equipment. Frankly, I do not think there was any excuse for providing that kind of equipment, nor does Defense management think there was any excuse for providing computers, desks, and office furnishing for consulting and study contracts.

In other cases there are good reasons—you mentioned some in your opening statement—to provide production-type equipment. Unfortunately, our contracting officers just were not very well aware of what was allowed and what was not. They went ahead and authorized these contractors in some cases to purchase that equipment. In other cases the contractors were not even authorized, but went ahead and purchased desks and furnishings on their own and we paid for those purchases.

Chairman GLENN. How do they specifically do this? If you have a contract number do you just call up wherever your supply might come from and use your contract number as an authorization for acquisition of certain desks?

Mr. VANDER SCHAAF. We have a cost-type contract and under the cost-type contract the contractor simply purchases the equipment, adds it to the cost of completing the contract. As I say, it is then expensed in one year and much of that type equipment certainly should not be expensed. It should be depreciated.

Chairman GLENN. How much of this is informational ignorance? I guess the question should be what is the basic cause of the failure of DOD personnel to follow what has been set down at least as DOD policy and procedures in providing OPE and paying fees? Is it ignorance of the policy or misunderstanding? Just negligence?

Mr. VANDER SCHAAF. I think it is all of the above. I do not know how to answer the question.

Chairman GLENN. Well, maybe you can add to my list. Are there more than I mentioned?

Mr. VANDER SCHAAF. There is a little of everything involved in that question of yours and certainly that all plays a role. Part of the problem is that we do authorize the purchase of items for a facility when the contractor is running a facility for the Government. In addition the FAR, the Federal Acquisition Regulations, did not really describe what one was to do with respect to consulting and study contracts.

Now, the Department has agreed to some real tough language in the guidelines for ordering this equipment in the future. Once the guidelines are in place, I think it will be very difficult for an administrative contracting officer or regular contracting officer to agree to furnish the kinds of things that we are talking about this morning.

Chairman GLENN. You would think that in a situation like this you would not need regulations. You would think that common sense would prevail in how we provide items to contractors and that the Government people responsible for approving such things would have some sense of protecting the Government's interest in this. But absent that—if it is absent, and I presume it is by the situation that we know exists—does the FAR, the Federal Acquisition Regulations, need to be revised to put more teeth in them or to tighten them up, or are they adequate if we just lived by them?

Mr. VANDER SCHAAF. I think they need a bit of revision in this particular area. Generally speaking, the acquisition regulations and the policy memoranda that the Department has issued with respect to this are clear now, with the exception consulting-type and study type contracts. I think we have to get into a situation where we have item-by-item approval in the contract. Then if we want to change that we make an amendment to the contract rather than an open-door policy with respect to buying equipment and then determining later whether we should or should not have purchased it or whether the Government will pay for it immediately.

Chairman GLENN. What is the answer? Do you have any other suggestions for us? Is property accountability a big problem?

We do not know whether people are ordering too much. We know that on occasion they have. Also, we know we have excess property on the shelves at contractor facilities.

What is the answer to this problem? Do we need a shake-up of the whole system? Or is the system adequate if we just had good people administering it?

Mr. VANDER SCHAAF. I think the system is fairly adequate, Mr. Chairman. When you get right down to it, the basic underlying policy is good. It says the contractor is responsible for providing the equipment and supplies needed to complete and deliver on the contract.

Unfortunately, we just do not push the regulations. Now, we do have a problem in the accounting area. I will admit that we have to do a better job in terms of financial accounting, and we have to do a better job with the inventory accounting as well.

We go in and do a property survey of each of our major contractors on an annual basis. The inquiries that my office has taken into those property surveys, show that they have not been very effective or very well done. We have to do a better job on those property surveys and accounting records. That will help us account for this property.

Chairman GLENN. Do you know of any examples where the contractor has kept OPE that has been improperly expensed under a contract and then on another contract depreciated the same equipment, or requested similar equipment?

Mr. VANDER SCHAAF. I do not off the top of my head, but I could sure go back and check and see if we have run into any of those.

Chairman GLENN. Is that a possibility?

Mr. VANDER SCHAAF. Certainly that could be a possibility, particularly if you lost track and the accounting records were no good. The contractor could then reconfigure that equipment, put it back to use, and bill the Department for it again. It would not be entirely impossible by any means.

Chairman GLENN. Well, thank you Mr. Vander Schaaf. We appreciate your testimony this morning. We may have other questions from staff or other committee members that are not able to be here. If we do, we would appreciate your response to those so that they can be included in the record when it is printed.

Mr. VANDER SCHAAF. Thank you very much. I appreciate your interest in this subject.

Chairman GLENN. Thank you. We are trying to do our best to look into it.

Our next witness is Mr. Richard L. Shaffer, Auditor General of the Navy.

We appreciate your being with us Mr. Shaffer.

We welcome your statement, either in its entirety or an abridged version. In either event, the entire statement will be included in the record.

TESTIMONY OF RICHARD L. SHAFFER, AUDITOR GENERAL OF THE NAVY, ACCOMPANIED BY LESTER PHILLIPS AND FRANK PETRILLO, AUDITORS

Mr. **Shaffer**. I would like to read the statement, if I may and then respond to any questions you might have, Senator.

Chairman **Glenn**. Fine. Proceed.

Mr. **Shaffer**. It is my pleasure to appear before this Committee today to discuss the topic of management and control of material furnished by the Navy to contractors for use in Navy contracts. During the past several years the Naval Audit Service has issued several reports on the ability of the Navy to adequately manage and control such property.

Two audits of particular concern to this Committee deal with our reviews of procurement and contract administration functions at the Naval Plant Representative Offices in St. Louis, Missouri, and Bethpage, Long Island, New York.

The audits in question were Contract Administration Office audits scheduled for initiation in the 1985 timeframe. They were not intended strictly as reviews of Government furnished material. Rather, they were designed to be comprehensive reviews of many important functions carried out by these offices.

During the conduct of these audits we hoped to achieve two ends, issue individual activity reports that would be comprehensive in nature and could stand alone in reporting many issues of substance in the area of contract administration, and obtain the necessary intelligence to select and audit in much more depth and on a systemwide basis those critical functions with questionable controls.

We believe we have achieved both ends. For example, the St. Louis report contained nine findings, all on issues of substance, in addition to Government furnished material, subjects included progress payments, unpriced orders and training of procurement personnel.

With respect to Government furnished material, we reviewed a selected number of contracts and associated Government furnished material reported on contractor records for end of calendar year 1984. In essence, we sampled $172 million worth of a reported total of $526 million of Government furnished material.

Within that sample, we found that $126 million of the DOD provided Government furnished material had experienced no demand for the calendar year. This observation led us to conclude that this material was excess to need with respect to those repair and overhaul contracts. We recommended that the program manager screen the material and redistribute unneeded assets to offset other requirements. The program manager concurred and took appropriate action.

Chairman **Glenn**. Can I stop you right there? Why did he need your gig to get him going? Why hadn't he done that to begin with?

Mr. **Shaffer**. It is a noncompliance finding, sir. Basically, the requirement is that he monitor execution of that contract and at a specific point in time when the program manager feels there is potential excess there, the contractor should initiate action to screen that material with the Naval Plant Representative Office involved. We found that the intent of the Federal Acquisition Regulation was not being complied with.

Chairman **Glenn**. Okay. Go ahead.

Mr. **Shaffer**. I might say that some of it is a matter of definition. The Federal Acquisition Regulation gives the contractor the discretion as to when to initiate that type action.

Likewise, the Bethpage report contained 15 findings in areas we consider to be significant to the Navy's operations.

We reviewed contractor inventory records for the end of December 1985. In this instance we reviewed Government furnished material associated with 76 production or repair contracts. Of a total of $336 million of Government furnished material, we determined that $121 million exceeded need. Most of this amount related to material which remained after physical completion of 23 contracts. As in the case of the previous audit, we requested the program manager to screen the material to redistribute the apparent excess against other needs.

In summary, both reports concluded that potentially millions of dollars of Government furnished material were excess to the needs of the contracts for which it was provided. In both cases we recommended that Navy management review the items in question and for those found to be excess, initiate appropriate action to redistribute the material. Such action could be to transfer the material to other contracts that had unfilled requirements, transfer the material to the wholesale supply systems for use in fleet support, or dispose of the material.

While we believe that our efforts on the two audits previously discussed were highly successful, we recognize it had two obvious drawbacks. First, since the audits were comprehensive in nature, they did not permit the time to conduct the reviews in individual areas in the depth we would prefer.

Second, since they were restricted to single activities, they did not permit the reporting of issues on a system wide or service wide basis. We have since supplied the intelligence gained from these two audits to system wide audits.

Initially there was disagreement with various levels of Navy management, both as to what constitutes an excess item and what therefore should be screened for redistribution. The basic disconnect evolves around whether or not support material list items are Government furnished material. For the most part, these disagreements have been resolved. We have been advised that as a result of the two audits, over $150 million of Government furnished material has been screened and disposition action taken, as appropriate. Such actions included the rollover of excess from one contract to another, the return of some materials to the wholesale supply systems, and legitimate site activation issues and disposal.

Of continuing concern, however, is the apparent inability of the manager to adequately account for final disposition of these assets. We may elect to officially surface this issue to the Navy management structure at the conclusion of a follow-up audit oriented toward tracing the final disposition of a portion of the material redistributed as a consequence of our audit at Bethpage.

I will defer drawing firm conclusions in this area, given that we have not conducted sufficient auditing to clearly understand the causes of this problem and whether or not cost effective remedies can be or should be applied.

I would like to alter the thrust of this statement toward other areas we were asked to comment on. The first relates to "cost-to-hold." In the St. Louis report we cited a Defense Contract Audit Agency estimate that the "cost-to-hold" agreement material in a contractor's plant was 25 percent of its value. We extracted this from a report that Agency had issued on potentially excess material at the St. Louis contractor facility.

We used it in our report as an added inducement to clear from the contractor's plant as quickly as possible excess Government owned material. "Cost-to-hold" inventory is a factor used by logisticians in a variety of inventory management formulas such as the Navy supply system's stratification process by which annual requirements and budgets are determined and supply demand reviews, during which specific purchase actions are recommended.

It tells the manager that, in addition to the cost to buy material, it will cost a certain amount of dollars to store it in inventory. It is generally made up of three sub-factors: Handling and storage—this is what the contractor charges either directly or through overhead to process and store the material; interest—this represents cost of money to the Government to finance these inventories. This becomes particularly important when Government furnished material excess to contractor's needs on a specific contract can be used to satisfy other Government requirements.

The other factor is obsolescence. This represents the cost of items that could become obsolete while under contractor control.

Although we did not audit the 25 percent factor, we consider it reasonable for two reasons. First, its source, the Defense Contract Audit Agency, audits the contractor's records on a continuous basis, and second, it compared favorably with figures used by the Navy in similar computations in accordance with Department of Defense guidance.

Additionally, this Committee has questioned the adequacy of Navy guidance to contractors in identifying and reporting excess Government property. Specifically, does the Navy dictate to contractors how to determine when property is excess or does each contractor make his own determination?

With respect to identifying Government property no longer needed for contract execution, we found that specific guidance is generally lacking. There is no firm requirement to review and identify such material during the lives of contracts. It appears the general policy has been to allow contractors to determine when and what criteria is to be used to identify material no longer needed.

We found that, in most instances, the Government was not notified of unneeded material until contract completion. Once a determination was made that the material was excess, the Naval Air Systems Command Contract Administrative Manual very forcefully pointed out the need to rapidly screen excess material and initiate prompt redistribution or disposal action.

In retrospect, the Federal Acquisition Regulation, paragraph 45.509-2, in part states that for Government property contractors develop procedures that establish a minimum level of use below which an analysis of need shall be made and retention justified.

We have not yet formally raised this issue within the Department. Once we firmly document that the need exists and inform the proper Navy officials of that need, action will be taken to remedy the situation. I do not mean to beg the issue, but in attempting to respond candidly to your concerns, I hope it is recognized that some parts of this testimony represent probable, not absolute, causative factors.

With respect to our current auditing efforts, in January 1987 we began an audit of the management of Government furnished material in the possession of contractors performing aircraft production and component repair and overhaul. The audit work is being performed primarily at commercial production and repair facilities at Government Contract Administration Offices, the Naval Air Systems Command and Naval Aviation Supply Office.

Its objective is to evaluate the ability of the Navy's aviation supply system to effectively and efficiently manage material furnished to contractors engaged in aircraft production and component rework. In this audit we are reviewing whether material provided under 51 statistically selected contracts is handled in accordance with applicable regulations, and whether stocking policies listed in the contracts and generally accepted inventory management practices are being followed.

We also are evaluating the adequacy of regulations and whether management has adequate visibility and controls to manage the material effectively and efficiently. Our preliminary observations are these: that Government furnished material is provided more as the rule than on an exception basis and that Navy management places more emphasis on providing the material than properly managing it.

Contractor facilities have evolved into Navy storage sites and the Navy wholesale supply system has minimal visibility of the material at these sites. We are finding that a significant portion of the material in the contractor's possession is excess to needs of the contract for which it was provided and that there are immediate system requirements that could be satisfied with this material.

We are also finding that the management of Government furnished material is fragmented. Managers do not uniformly interpret and apply existing policies and procedures for providing, accounting for, and redistributing Government furnished material. We expect to issue a final report in this area within 6 months.

Finally, you asked me to identify what I believe to be the most serious problems relative to Government furnished material and what is needed to correct them. I believe the individual Navy manager has to recognize that Government furnished material, currently provided at a rate of a billion and a half a year—and that is in the Naval aeronautic area only—represents a potential asset to the Navy's wholesale supply system, if in fact, at a point in time some portion of that Government furnished material exceeds need relative to its parent contract.

Finally, it must be recognized that unneeded assets will accrue to any inventory system. Accordingly, Government furnished material inventories must be monitored on a continuing basis to ensure effective and efficient use. Visibility must be improved so that excesses can be identified in a more timely manner. This would enable the Navy manager to direct redistribution of the material to best satisfy the overall needs of the Navy. This includes, when appropriate, timely turn-in of material to the wholesale supply system for use in fleet support.

Mr. Chairman, that concludes my statement. I have with me two of the auditors working on our current audit, Mr. Lester Phillips and Mr. Frank Petrillo. We will be happy to address any question you or any member of this Committee has.

Chairman GLENN. Fine, they could join you at the table if you want.

My first question is whether you believe that this kind of long supply or excess problem that some of this government furnished property gets into, is a common practice of all contractors. That is, are excesses kept by contractors and are they used, in effect, as Navy supply dumps?

Mr. SHAFFER. Why don't I ask one of these gentlemen? Would you like to answer that one?

Mr. PHILLIPS. Based on our current review where we have visited approximately 20 Government contractors, we are finding that this situation seems to be prevalent at all locations, that excesses are building up.

Chairman GLENN. Can you give me an estimate of what material being held by contractors would be common to all contractors?

In other words, it would be one thing to have a specific airplane being manufactured and to have specific parts being manufactured for it, which are supplied by the Government—altimeters, to use the example I used earlier today—that we want to be common to all aircraft. It is cheaper. It involves flight safety so that they have exactly the same design so you do not mis-read altimeters, which used to give us a problem. So we supply those altimeters as Government furnished property.

It is one thing to supply things such as altimeters. It is another thing to have sheet aluminum or whatever of a certain quality supplied that would be common probably to all manufactures.

Do you have any idea of what percentage of materials are common to most DOD contractors? In other words, if one manufacturer had a big over-supply of common material, somebody else might need it, but DOD does not even know there is an oversupply at the other plant.

I did not state that very well, but I think you get what I mean.

Mr. SHAFFER. Yes, sir. Let me try to answer that this way. We are dealing specifically with Government furnished material in the aeronautic area. If I am in the Navy and want to contract for production or repair of aircraft, I would provide an amount of material to the contractor which is specifically designated as Government furnished material.

This would be material similar to the altimeter you mentioned. What we are dealing with are spare parts and material such as the avionics that go on individual aircraft.

When the contract is let with the private contractor, the Government furnished material provided in this instance is normally material to support actual production of the aircraft or in the support material list area. It represents items which are not currently within the supply system, meaning not being supported by the Navy wholesale supply system.

Let's talk about duplication of items. These gentlemen, during the current audit, took a sampling of spare parts by national stock number or by part number. They then matched the potential excesses they identified at the contractor facilities against what was within the Navy wholesale system being supplied to multifaceted Navy customers.

They found a significant portion of inventory that was deemed excess in the hands of an individual contractor—something in the neighborhood of $25 million—could be used to offset immediate requirements within the Navy wholesale supply system. Some of the requirements represent material currently on back order.

Chairman **Glenn**. Had it been turned back in.

Mr. **Shaffer**. Would the material have offset wholesale supply needs had it turned back in? Yes, sir. We are talking in the neighborhood of 20 percent of the potential excess identified. How realistic that is when related to the overall value of Government furnished material provided by the Navy, I am not sure. But from the testing we have done, given the sample we had, that is the type of factor we are looking at.

Chairman **Glenn**. Do you have a feel for how much of the material is material that is common at a number of plants? I guess that is the question I was getting at.

How much is bulk-type material? How much would be sheet metal or steel of a certain caliber or quality or whatever that would be usable at several places? Somebody may be buying it over here not knowing it is stockpiled at another plant.

Mr. **Shaffer**. In the Government furnished material area, we are not considering very much of that type of material. Within total Government property there is a sub-category referred to as Government furnished material. That is what we are dealing with here—mostly spare parts, avionics, Government furnished equipment that relates specifically to production aircraft. The sheet metal portion of it and the part that is used to actually fabricate the skin of the aircraft, that is in another material category.

Chairman **Glenn**. Your statement indicated that at McDonnell-Douglas you sampled $172 million and found $126 million worth of material had no demand in the past year, and that gets in the long supply category. It sounds like a tremendous waste. Some Navy personnel in contractor management has told our staff people that the situation is not nearly that bad. There seems to be a real difference of opinion here between your audit and what some of the Navy management people are saying.

Is this a cover-up there, in your opinion, or what is it?

Mr. **Shaffer**. Here is where we get into the interim spares theory, the support material list category of material support. The Department of Navy acquisition manager would argue that when he lets that production contract, there is an amount of spare parts support required to outfit the initial site where the aircraft is to be deployed.

He would argue that from the point in time the first aircraft is delivered until they fill that site, that there is an amount of spare parts support required for those aircraft, and that these are parts not supported by the supply system. He would then state that until the supply system picks up the material support date, that those interim spares will provide that type of support for the aircraft after they are delivered and that the residual amount of those resources will then be combined with a larger buy made by the Navy and eventually end up at these sites to support those operational aircraft.

However, according to the manager's concept, those interim spares should be experiencing demand. At the St. Louis facility we looked at spares in that category and observed that a significant amount of them—over $100 million worth—had experienced no demand or significantly less than anticipated demand in a 12-month period. So we have theory on the one hand and the reality of what we observe as they execute these programs on the other hand, and they just do not match.

Chairman **Glenn**. It seems to me there is something very fundamentally wrong here too when people want to deliberately fence off certainly categories of equipment or material at a contractor plant. Apparently this is done because they have a doubt about whether the supply system itself can monitor that item or keep it in sufficient supply that the Fleet can be serviced later on.

Some of my staff visited Grumman. They were told that millions of dollars in supplies were being deliberately fenced off, as they termed it, for future uses such as provisioning new carriers, new squadrons.

It was not the Grumman people particularly. It was some of the Navy people at Grumman who expressed concern that the Navy supply system probably was not the best place to have this material. They believed the Navy supply system could not be trusted to leave the material intact, and as a result there was a deliberate interest in not allowing the supply system to have adequate visibility over these assets.

Is that true? And if so, what kind of efficiency is that?

Mr. **Shaffer**. I am an internal Naval auditor so more of my blood runs Navy blue than more other auditors. I am a strong advocate of the Navy. Within the Navy, we have a problem of fragmenting the management of this material.

What we have to do as internal auditors within Navy, if what you said has merit, and we suspect it has, we have to document it and take that message formally to the CNO and to the Secretary. We have to emphasize that within Navy there has to be a management structure which allows visibility of these parts to flow across these fragmented lines. Only by doing that can we begin to manage these items as a Navy asset as opposed to a NAVAIR or a supply system asset. I think you have hit on one of the problems within Navy.

Chairman **Glenn**. Do your reports get to CNO, and are they given credibility at CNO? Has any action been taken on them?

Mr. **Shaffer**. Yes, sir. Two or 3 years ago, if you look at the Bethpage and the St. Louis audit, you will notice the Audit Service was doing basically activity audits and you will see a number of those recommendations addressed specifically to either the Naval Plant Representative Office or to the Naval Air Systems Command.

What we do in today's environment is surface these issues to the CNO or the Secretary level. Secretary Ball, as you are well aware, is deeply interested in this issue.

Chairman **Glenn**. If you have had supplies out there with contractor and there has been no call on them in any way, shape or form for a year, do you consider them in long supply?

Mr. **Shaffer**. What normally happens, sir, is once they revert back into the supply system, the wholesale system, they then get logged against total system requirements, and to the extent that they have no potential demand, they then end up in long supply. This is one of the contributing factors to the growth in long supply; yes, sir.

Chairman **Glenn**. Well, when an aircraft manufacturer, Grumman, McDonnell-Douglas or whoever, is ordering something from DOD supply system, how do they verify that it is needed, that it is used on contracts and that we know what material is still on hand and know what they should have on hand? Is there a follow-up on that?

Mr. **Shaffer**. I would like to answer that one for the record, if I may. There is a system that the Naval Air Systems Command manages that has policies that should properly answer your questions. I can talk to it in generalities.

Chairman **Glenn**. Go ahead, and then we could have a more detailed statement later for the record.

Mr. **Shaffer**. Yes, sir.

[The information referred to follows:]

Under the Navy's independent verification and control procedures implemented at Grumman Aerospace and Ingalls Shipbuilding Corporation, requisitions placed on the DOD supply system are validated by Navy employees before they are entered into the system. This validation is performed on either a comprehensive or valid statistical sample basis depending on the volume of comparison of requisitions against requirements identified and authorized in contracts or mutually agreed upon work orders for those situations in which it is not possible to tell in advance what requirements will be (i.e. open inspect and repair orders). All remaining Navy contract administration activities are scheduled to implement this system by October 1989.

Under the existing Federal Acquisition Regulation, the contractor maintains the accountable record for all material he has ordered and has on hand. The Department of the Navy provides systems oversight through our property administrators located at the contractor's place of business. Areas tested and validated by the government in accordance with Federal Acquisition Regulation Supplement Number 3, include standard operating procedures, beginning inventory (we use the official government shipping documents, i.e. DD 1348 or DD 250), records of on hand and issued/consumed material, and accuracy and adjustments to those records. The contractor must maintain an acceptable system or he becomes financially liable for all Government material in his possession. As material is issued and consumed on contracts, records must be annotated to show the contract number and the actual job upon which the material was used. Material that is not consumed will remain on the accounting records of the contractor. Under present rules, that material will be disposed of at the time the controlling contract is closed out.

Mr. **Shaffer**. If you want an aircraft and you are within Navy, you have to get with the people who have the capacity to produce it, and there are rather lengthy sessions that occur. There are a lot of engineering estimates when there is an idea of what is to be built. If it is beyond the research and development phase and is close to production, we can state with a reasonable degree of certainty what the individual components are that will make up that specific aircraft.

Within each of these components there are estimates that identify specifications for each item, the numbers of items required to support a certain productivity posture and lists of material required are prepared. A determination is made as to which part will be provided by the Government and which part will be provided by the manufacturer. At the end of that process, these specific lists are computed and the procurement action required to bring these parts into the production area takes place. It is a very sophisticated and very complex process.

The people doing it are very good at what they are doing. We tend to err on the engineering estimates because without firm usage data we tend to buy parts that we anticipate we will need when in reality a few years later we look back and realize we did not need all those parts.

Chairman **Glenn**. What would you have to say about the adequacy of the acquisition regulations? Are they adequate and they are just not being followed, or do they need to be overhauled?

Mr. **Shaffer**. No one on my staff has told me that the Federal Acquisition Regulation needs to be revised. It appears the policies are there. The one minor policy that we mentioned in the statement is that we need to do something to trigger the contractor to react and identify potential excesses a little earlier.

Chairman **Glenn**. Okay. We are going to have to move along here.

Do either of you other two gentlemen have any comments you wish to make? You have not made any comment at all yet here.

Mr. **Petrillo**. No, thank you.

Chairman **Glenn**. Fine. Thank you.

Thank you, Mr. Shaffer. We appreciate it very much.

Our next witness is Mr. Frank C. Conahan, Assistant Comptroller General, National Security and International Affairs Division of the General Accounting Office.

Mr. Conahan, welcome to the hearing and we look forward to your testimony.

TESTIMONY OF FRANK C. CONAHAN, ASSISTANT COMPTROLLER GENERAL, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY GEORGE JAHNIGEN

Mr. **Conahan**. Thank you, Mr. Chairman. We appreciate the opportunity generally to support you in these series of hearings. We think this is an extraordinarily important area and hopefully these will result in some further actions that are sorely needed.

Three years ago, Mr. Chairman, Mr. Vander Schaaf and I appeared on a panel discussing these very same problems.

Derek spoke after I and he began by saying that my statement had covered much of what he intended to say and therefore he might just reiterate a few points.

Well, Mr. Vander Schaaf and Mr. Shaffer indeed did cover a number of the points that I intended to make.

But, in as much as some of these problems have been around for a quarter of a century and in as much as numerous recommendations have been made by the General Accounting Office, the DOD IG, the Service audit organizations and committees of the Congress, I think that I would like to re-emphasize several factors that indeed do contribute to these problems.

I have a rather detailed statement which I would like to submit for the record [1] and then perhaps just make an abbreviated version of it.

Chairman GLENN. Fine. The long statement will be included in the record.

Mr. CONAHAN. Thank you, Mr. Chairman.

Let me begin by saying that the exact amount of Government property currently in the hands of contractors is unknown. As you mentioned in your opening statement and as was covered by previous witnesses, there was a system established in 1986 to periodically report on the value of property in the hands of contractors.

The data collected by DOD showed that in 1986 the amount was somewhat on the order of $45 billion and more recently in September of 1987 over $51 billion. I would like to point out, however, that in our view that may not be the exact amount. Indeed, we believe it is not the exact amount. We believe it is higher rather than lower because in our review we found inaccurate and incomplete reporting.

We also found that some contractors did not submit any data at all. There are a number of examples of that in our report which show dollar amounts by some contractors did not get reported, as well as the number of items.

I have an example here from one contractor involving four contracts where he did not report values for over 56,000 out of over 65,000 line items of Government-furnished material. The value of the remaining 9,000 line items was about $59.6 million. That is a fairly significant deviation from complete reporting. There are other examples.

I believe, Mr. Chairman, there are several factors that contribute to the problems in controlling and accounting for material furnished to contractors. First, as has been mentioned here earlier, DOD has not effectively implemented the basic policy of relying on contractors to provide material for their contracts.

We found almost without exception in the contracts that we reviewed that material was routinely furnished when we believe it probably should not have been. For example common type items such as common hardware and office supplies were furnished out of the DOD supply system, as well as some other more military-unique items. In some instances, we determined that the material could have been obtained commercially at a lower cost.

Second, the services have not yet implemented, or inadequately implemented DOD instructions designed to adequately control contractor access to the DOD supply system.

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[1] See p. 77.

Although 6 years have passed since DOD guidance was issued calling for the creation of MCAs or Management Control Activities designed to control contractor access to the DOD supply system, this has not been adequately done throughout the three services. The Air Force has established such management controls, but current procedures still do not insure that contractors receive only needed items and amounts of material.

The Army and the Navy have much further to go.

Third, our work in recent DOD audits disclosed weaknesses in both contractor controls and Government oversight over Government-furnished material that have contributed in many cases to excess material and certainly to potential excess material situations that have not yet been resolved. There are examples of that in our statement. You have heard examples of it from our previous witness and I need not say much more about that.

Fourth, as I mentioned at the outset, DOD does not yet have an adequate property accountability system nor indeed financial accounting controls. We first recommended that these controls be established as far back as 1967. There has been some movement, really not much movement, until the early 1980s. In 1983 DOD finally established accounting principles and standards for Government-furnished material and equipment. DOD and the services are working on developing the required accounting systems and the implementation date is now estimated at 1989.

Turning to Government-furnished equipment, as contrasted to Government furnished material, which was the subject of our most recent work, this area has been marked by many of the same problems. In our most recent report on that activity dated June 1986, we advised the Secretary of Defense that problems which we had noted over a dozen or more years before that remained. You heard some of those same deficiencies from Mr. Vander Schaaf earlier.

In summary, Mr. Chairman, DOD and the services have had longstanding problems in almost all aspects of control and accountability over property, both equipment and material.

These problems continue. Therefore, there is no assurance that the Government's very sizeable investment in property has been adequately protected, that the potential for waste, fraud, and abuse is minimized, and that the maximum benefits accrue to the Government. To insure that the various actions that are required to correct these indeed are undertaken, we would recommend that the Secretary of Defense establish some very specific milestones or due dates for getting some of these things done.

That is one thing that we feel has been missing in the past. Certainly the recommendations have been there. The implementation has been the problem.

That concludes my comments, Mr. Chairman.

Chairman GLENN. Thank you very much.

On the MCA, Material Control Activities, what is their purpose? Are they DOD wide? Do they apply to everybody?

Mr. CONAHAN. It applies to everyone. DOD told each of the services to establish the MCAs as was necessary to insure control over the provision of this material to the contractors.

Chairman GLENN. In your longer statement you give some examples of where that has not been done. The Navy has not established those activities at their supply depots, and will not, apparently, until late 1989; is that correct?

Mr. **Conahan**. That is correct, Mr. Chairman, both in the Navy and the Army. The Air Force has established MCAs, but they simply are not working very well.

Chairman **Glenn**. How complex are these systems? Does it take that long to put them in? This has been underway since when?

Mr. **Conahan**. The direction was initially given in 1981.

Chairman **Glenn**. And it takes that long to get something going?

Mr. **Conahan**. I do not think that it should take that long, Mr. Chairman. I think that what we are talking about here simply is a matter of resolve to do it. There are a number of complexities involved in this but I think initially we need the resolve to do it.

What we are talking about essentially is setting up a system whereby material proposed to be furnished to a contractor is adequately reviewed, before approval is given for that property to be furnished.

Chairman **Glenn**. Does the MCA also require a follow-on of keeping up with the status of the inventory once part of it has been used and there is still an amount of material at the contractor?

Mr. **Conahan**. I think that the responsibility for that is split. The MCA certainly has that as part of its charter, but also the property administrators who are part of the contract administration activities at the various plants throughout the country have that as a responsibility. In fact, property administrators are required annually to make surveys of what the situation is with respect to material furnished to the contractors.

We found that in many cases they are not doing that and in many cases property administrators are simply not available to do it.

Chairman **Glenn**. You give a couple of examples in your longer statement on, for instance, the compressor doors you mentioned. I do not know who the manufacturer was, but the DOD supply system price was $253 each. They were not available from the DOD supply system so a contractor went out and purchased them commercially for $21 dollars each.

Did you run into many examples of that?

Mr. **Conahan**. There were other examples of it. I do not have them right off the top of my head. But what you are talking about there is the DOD catalog price. And certainly there are a lot of other charges that get put into the price of a DOD item, as you well know.

Chairman **Glenn**. Would it be correct to say that our policy of requiring contractors to provide the property and material needed is premised on the notion that they will economize on the items purchased? And that the contractor loses this incentive when free Government goods or when Government-provided goods are given to them?

Mr. **Conahan**. The concept is that the best arrangement for the Government would be developed, but that certainly has not been the practice. And I quite agree with you, the incentive for a contractor to take those steps is simply not there.

Chairman **Glenn**. What is your reaction to the reporting system set up by DOD to gather the acquisition costs of Government-furnished property provided to defense contractors? I know the system is a little bit new, maybe, to comment specifically on all of its accuracy, but overall do you believe the costs reported are about on target, too low, too high? Are there procedural flaws? What is your comment on that?

Mr. CONAHAN. I think, as you point out, it will take a little time before we can have full confidence in the values that are reported. We did find in the instances that we reviewed that values were not reported. We found some fairly significant amounts that were given to the contractors that we looked at.

I think what we will need to do is to review the reporting system over time to see how much the accuracy of the system continues to improve.

Second, the reporting system for most of the items of Government-furnished property, and this is particularly true in the equipment area, call for the reporting of additions and deletions during each fiscal year; that is the provisioning of property to the contractor as well as the amount of property used, returned, or disposed of under each contract.

That information is not called for with respect to Government-furnished material, the kinds of things that we have been talking about here, both, the very large items as well as the smaller and common items that come out of the DOD supply system. We think that if that information was provided, the reporting would be much better because then we could do some analysis that you simply cannot do by looking at beginning and ending inventory balances.

Chairman GLENN. You have concentrated some of your work on controls over providing and accounting for Government furnished material to service and to maintenance-type contractors.

Mr. CONAHAN. That is correct, sir.

Chairman GLENN. And you found some very serious problems such as giving contractors access to DOD's supply system with really little, if any, control over the requisitions.

Would you want to expand on that a little bit as to what DOD follow-up there is, if any, on whether contractors requisition were too much? What follow-up is there in some of those cases, with particular regard to service and maintenance-type contracts which require such things as paint and glass and other common items that are subject to being misused or stock piled in a contractor's own warehouse?

Mr. CONAHAN. We found that indeed there were potential excesses and then some excesses indeed of the kind of items that you are talking about. The thing that we have got to focus on is the activities at the contract administration houses and their insufficient property administration.

As I mentioned a few moments ago, property administrators are required to perform annual surveys of the contractors' property control systems. The surveys address such diverse areas as acquisition, use, and consumption of property and recordkeeping. These surveys are, in many cases, not done in an adquate manner or, in some cases, not done at all.

Chairman GLENN. Did you get into this in sufficient detail to find examples where people had requisitioned—I do not know why paint keeps coming back, but paint is one that is common to almost everything we do—amounts of paint or other commonly used items and had used them for purposes other than that for which they were requisitioned?

Mr. **CONAHAN**. I do not think that I have a current example are where they were being used for something other than what they were requisitioned for.

Chairman **GLENN**. Did your investigations get into it in sufficient detail so that if that had been done you would have picked it up?

Mr. **CONAHAN**. Not necessarily. What you are able to see out there is that weaknesses in both contractor controls and government oversight over material have contributed in some cases to the accummulation of excesses. But unless you specifically go after the kind of activity that you are talking about, you are not going to find it and we did not do that.

Chairman **GLENN**. It appears to be very easy, from all the testimony we have had this morning, for contractors to requisition material, and heaven only knows how many billions we are going to add to our long supply because of this. And these, contractors' excess supplies, I might say once again this morning, just so everyone understands, are not part of the long supply problem displayed on the chart.[1] These are in addition to that.

We were talking about the $30 billion up to the end of 1986, $30 billion plus all of these billions that we are talking about here this morning. So we are talking about an even bigger problem than we thought it was when we first started out.

It would appear people are much too lenient in honoring requisition requests and in giving away Government material, in effect; much of it for good purpose. I do not question that.

But the question comes back then, does the FAR need to be clarified on furnishing Government property?

Mr. **CONAHAN**. I think that in so far as the policy is concerned, the FAR is adequate. It requires that contractors are to furnish all material and equipment necessary to perform government contracts unless it is determined to be in the bset interest of the government to provide the material or equipment.

Now, with respect to Government-furnished equipment, the FAR currently lists a number of exceptions and if any of these exceptions are met, then the equipment can be furnished.

We have recommended that those exceptions be clarified.

They are very vague in some cases and it permits contracting officers to provide just about anything that one might think is necessary for that contract. So we think that there is a need for some adjustment right there. I understand that there is a FAR case under review on that. I have not seen where they stand on that.

Chairman **GLENN**. If I am a contractor and there is something that is going to be furnished to me, either a raw material or a certain piece of equipment, I am probably going to tend—so that my production is not delayed—to order more than I otherwise would just to make certain that my needs are met and that I am not in default on the contract.

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[1] See chart on p. 198.

Did you get into that? How much of that mentality is behind some of the excesses that build up at these plants?

Mr. Conahan. Well certainly a contractor has no incentive to do otherwise. He has got no financial risk whatever here. He can order what he feels is necessary in the absence of the property surveys and inspections that I talked about.

There is little risk that it will be noted that that is the position that he is in. And there are no penalties presently for his being in an excess position.

Chairman Glenn. Did you have any indications or did you find any cases where you happened to know that one company was ordering items that were in excess at another company or the Government itself was going out for new buys for an item when we already had excesses at one plant?

Mr. Conahan. We may have a very specific case in this regard that I think was alluded to in the the Navy Audit Service report with respect to the Hughes Corporation.

But the point that I would like to make is that that can easily be inferred. A very large part of this Government furnished material is material out of the stocks of the Defense Logistics Agency. These are commonly used stocks. If you are talking about the aviation area, you are talking about common aviation parts.

If you are talking about the automotive area, you are talking about common automotive parts to such things as materials that are used for service contracts, to such things that are used generally for maintenance contracts throughout the services.

Chairman Glenn. Much of this Government furnished material—I keep coming back to consumable items as opposed to certain specific parts for the Fleet with the Navy or on a tank for the Army.

That is one that really is a tough one for me to get a hold of because it is so easy to over order on common, consumable material and divert it to other purposes.

Do we need special regulations with regard to consumable materials as opposed to stockpiling of parts or specific instruments?

Mr. Conahan. There are studies underway right now, Mr. Chairman, both within our organization as well as by the DOD IG. And this goes to the material handling procedures that we talked about a little bit earlier.

Part of that arrangement requires the commingling of certain parts as between defense contracts and commercial contracts. I cannot give you an answer right now but yes, I think that we do have to look at that very closely because the criteria there, and the implementation, I am afraid, might be very close to the kind of situation that we find here. But I do not have a definitive answer.

Chairman Glenn. DOD's answer to most of this, as I understand it, is that they have fixes underway for most of these deficiencies that we have been only touching on very briefly, hitting the tip of the iceberg here today. Have you had an opportunity to asses DOD's corrective actions to date and do you believe additional corrective actions are necessary?

Mr. Conahan. I think that their corrective actions over a long period of time have been inadequate. There has been some movement. I have to look towards a lot of hope and trust because the track record is not very good in this respect.

Chairman GLENN. Is part of the problems just that directive are not followed once it gets downhill, or are the directives adequate, or do we need direction from on high from the Secretary himself to make this work?

Mr. CONAHAN. I think two things. Certainly the policy seems to be reasonably good. I said there were some little things that we could tweak. But there is reasonably good policy. What we have is a failure to implement.

There seems to be a low priority generally throughout the defense establishment in this area.

Decisions get pushed fairly far down into the organization to the contracting office and program office level.

As you know, Mr. Chairman, within those organizations the emphasis is on schedule, to get the thing moving, and not too many people are willing to raise the kinds of questions that need to be raised in order to assure that the problems that we are talking about right now do not continue.

Chairman GLENN. Does the whole system need to be jacked up as far as sensitivity to accountability goes?

Mr. CONAHAN. I think so, sir.

Chairman GLENN. I guess that is one of the things we are trying to do here today.

Do you see the need for any major changes, perhaps even legislation in this regard to help DOD or to force DOD's implementation with respect to GFE and GFM, or both?

Mr. CONAHAN. I am always reluctant to infer legislation when regulation can do it. I think that the problems that we have talked about here can be taken care of by implementation of regulation. Perhaps somewhere along the way, if this does not occur, and it has not occurred, then legislation might be in order.

Areas which such legislation could address might include developing contract provisions that increase contractor incentives to effectively manage government property and defing the conditions under which general purpose equipment and material readily availble from commercial sources can be provided to contractors.

Chairman GLENN. We might need legislation, but I must admit I do not know what legislation I would propose right now except just to put into law, say, do it.

Mr. CONAHAN. I agree with you. The only other thing is some part of penalty and I do not endorse that at all.

Chairman GLENN. Do you have any examples you could give us, or could you give us the most egregious example you have uncovered with regard to inadequate accountability or controls over the issuance of Government furnished material to contractors?

I believe you had quite a few in your more lengthy statement here. You might want to go through a couple of those.

Mr. CONAHAN. George Jahnigen has been the principal mover of this body of work. I am going to ask him.

Chairman GLENN. Well, bring him to the table there. That would be fine.

George, come on up and join us here.

Mr. **Jahnigen**. The example that comes to mind involves an Air Force contractor in Florida who, using his DOD Activity Address Code, submitted multiple requisitions for an electrical part managed by the Defense Electronics Supply Center. The contractor was authorized to obtain 90 items; however, he submitted 45 requisitions for 19 parts each, for a total of 855 items on the same day. The Supply Center had put a maximum quantity limit of 20 parts per requisition on this part and, by ordering one less part per requisition, the contractor avoided all existing checks designed to prevent Air Force units, as well as contractors, from depleting wholesale stockage levels. The multiple contractor requisitions depleted the entire DOD inventory of these parts. Also, the Air Force's MCA system did not detect that the contractor requisitions exceeded the authorized quantity for this part.

Chairman **Glenn**. Was this intentional? Was this deliberate fraud?

Mr. **Jahnigen**. No, sir. We did not find any evidence that there was any fraud. In fact, the local Government official was aware of this situation and endorsed it.

Mr. **Conahan**. Mr. Chairman, may I add to that. I think that is very, very important. In many of these cases the service representative is very fully aware of the transaction that has taken place at the local level.

So one of the things that this statement talks about is contractors using military codes rather than contractor codes so as to avoid certain of the edits that are in place that would come into play if a contractor code was used. And the local buyer, the inventory control point, or whomever, is fully aware that that activity has taken place.

Chairman **Glenn**. Do we just need better people monitoring this at the local level? If the local Government representative, plant representative, wherever that person is, knows these things are going on, knows there are excess requisitions going on and does not do something about it, the whole system breaks down from there on up, does it not?

Mr. **Conahan**. Well, I think it is a mixed bag. I think in some cases they do and in other cases they do not. But where they do, yes, I think that there needs to be greater attention by top management to this area.

Chairman **Glenn**. Well, it would seem to me that most of the officers involved with that kind of monitoring should have their efficiency reports and their career processes commented on in a negative way for their next promotion if they permit such a thing as that to happen. In fact, it would seem to me that that would be rather fundamental.

Okay. Thank you, Mr. Conahan.

Has Dr. Costello arrived yet? I understand he will be here in a very few minutes, so thank you, Mr. Conahan very much and we will recess just temporarily here for a couple of minutes until Dr. Costello gets here.

[Brief recess.]

Chairman **Glenn**. The hearing will reconvene.

Our next witness is Dr. Robert Costello, Under Secretary of Defense for Acquisition out of the office of the Secretary of Defense.

Dr. Costello, perhaps you would like to introduce the other gentlemen here for the record.

TESTIMONY OF ROBERT B. COSTELLO, PH.D., UNDER SECRETARY OF DEFENSE FOR ACQUISITION, OFFICE OF THE SECRETARY OF DEFENSE, ACCOMPANIED BY JIM KORDES, ASSISTANT FOR INDUSTRIAL POLICY, AND JIM REAY, DIRECTOR FOR SUPPLY MANAGEMENT AND POLICY

Dr. **Costello**. I certainly will Senator. I can start off by apologizing for the spring weather in Washington. The traffic is still tied up over there on the bridge.

But we thank you very much, Mr. Chairman. It is a pleasure to be here to testify this morning before your committee regarding management of Government furnished property by the Department of Defense. I would like, as usual, to request permission to insert my prepared statement for the record.[1] It provides a more detailed position of what we are doing.

Chairman **Glenn**. It will be included in its entirety in the record.

Dr. **Costello**. I would like also to introduce the two members of my staff who have accompanied me; Jim Reay, who is Director of Supply Management Policy; and Jim Kordes, who is Assistant for Industrial Policy.

Let me say that we sincerely appreciate the Committee's continuing interest and concerns on the subject of property in the possession of contractors. We fully understand the nature and motivations for the hearing.

We in the Department of Defense, as owners and operators of the world's largest supply system, an extremely important responsibility supporting our national defense, recognize that there have been shortcomings in the area of property management.

Even though we have re-evaluated and reordered our priorities in this area and will continue to work diligently to improve things, it nevertheless remains a difficult undertaking to maintain, or perhaps even impossible undertaking to maintain a 100 percent perfect inventory control system. But our goal is for substantial improvement.

The most important point now is that we have moved to correct the shortcomings that have been identified through our own work, the work of the GAO, and the IG.

We are planning more corrective actions within the near future. Particularly, we are making it a priority issue when dealing with our contractors. To accomplish our objectives for attaining a superior materiel management system, we are seeking the support and cooperation of everybody who has a stake and who is in a position to help and contribute.

This includes, of course, most importantly, those people in our own department; our own managers, including myself, and the staff in the Office of the Under Secretary of Defense for Acquisition, property management personnel, and the Department of Defense IG. We have been working very closely with Mr. Vander Schaaf.

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[1] See p. 166.

This also includes working with our contractors; a broad variety of industry associations to make sure we get the message out to the contractors, and so we can test our statements to make sure they understand where we are going and what has to be done; the Congress, of course; the General Accounting Office; and other professionals we deem appropriate from outside the Department.

We are confident that we now have a better handle on this area, but we are not finished. We are still open to suggestions as to how we can continue to make improvements. We will be glad to discuss those improvements as we define them.

Mr. Chairman, that concludes my remarks. Again, we appreciate being here and will be glad to respond to your questions.

Chairman GLENN. Thank you very much, Dr. Costello.

We have some $51 billion that you have identified in either Government furnished equipment or property or material and yet we rely on the contractor to certify those records and give us a count of what is actually out there; is that correct?

Dr. COSTELLO. We have appropriately identified the responsibility being with the contractor. We look at his system. We approve his system. We monitor and audit the system to insure that it is performing as it should by telling us how much he has and where it is.

Chairman GLENN. How do you know he is telling you exactly what he has?

Dr. COSTELLO. We have checks and balances built into what we send him. We have looked specifically at the details of his property accounting system. It is the responsibility of the contracting officers involved in that contract to——

Chairman GLENN. How do you know what you send them? You do not know what you have sent them, do you?

Dr. COSTELLO. We have records of what we sent. We have records as to what total receipt and issues are at the present time.

Chairman GLENN. Why then are we asking them what they are supposed to have on certain overhaul equipment and things like that?

Dr. COSTELLO. Detailed records should be kept by whomever maintains the material. You have to associate the records with the materiel. I have done a lot of work in industrial inventory control. You must have the records where the materiel is. If you move the records echelons away. You lose total control. You are always trying to check the records themselves rather than having the accuracy and the responsibility down at the proper level.

Chairman GLENN. If General Motors sends so many truck bodies to Lordstown, Ohio, do they keep any record on it? Do they just depend on Lordstown to tell them how many they have? That would be a similar system to DOD's.

Dr. COSTELLO. The level of detail that is necessary has to be maintained by the contractor. If we do not trust the contractor to keep the material records, we probably should not trust him to do anything.

Chairman GLENN. Well, I cannot quite imagine this. You say DOD is the biggest business in the world, and it is. There is no doubt about that. But I used an example starting out the hearing this morning just to put it in terms so that everyone could understand it.

If I owned the Hechingers stores here in Washington and I wanted to build half a dozen houses, and I hire someone to build those houses. Then, I say that I will furnish all the material to build the houses. I ask the contractor to furnish the labor, and the expertise and everything else it takes to build the houses.

And I say, come on over and I will give you the material for this. And they show up with a truck, and then they show up the next day with a truck, and the next day with a truck. And they get pipe and lumber, materials, locks, doors, hinges. They get the whole works, and they take them off to their warehouse. They are building other houses, and they just keep coming over with the truck.

Now, it just does not sound right to me, it does not sound right from a businessman's standpoint either, that I would just keep loading up their truck. I would go over to their warehouse and say, now what have you put in the houses, and what inventory has actually gone in the houses I'd know what was going on.

Dr. Costello. I think we have taken a step even beyond that. The contracting officer is supposed to say, you are allowed to have four wheels for every four-wheel vehicle that you have, or a wheel for every rim, tires for every rim, and that is what you are going to be allowed to obtain. That is the kind of system that we are aggressively implementing today. So the contractor is only authorized to take from the system or receive from the system what he has been approved to get for current contracts.

That is the kind of control that we are looking to implement during the next year, or year-plus, depending on the Services' ability to respond.

Chairman Glenn. So we are going to have controls on exactly how many wheels he received, how many were requisitioned, how many were sent, how many are on hand? There will be a system set up to do that?

Mr. Reay. Yes, sir. That is exactly correct. The system that we are putting into place will actually control the contractor's access to the DOD supply system on the basis of contractor, contract number, specific stock number, and quantity in those cases where we can identify it. That will be most of the cases. Obviously, there will be a few exceptions where the specific quantities will not be known until later in the contract process.

Chairman Glenn. Well, how about the examples we discussed this morning? In one case a contractor had $336 million of Government funished material and $121 million was excess to the contractors' needs. At another contractors auditors examined $172 million of GFM and found there had been no demand on $126 million of the GFM for a year.

Is your new system going to be set up to take care of that? Because I do not think right now DOD can tell what it has issued to contractors. It just depends on what the contractors say they have.

Dr. Costello. The answer to the question is yes. We are going to have a system that will allow us to have the records just as you described; just as Mr. Reay described.

For each contractor it will be well identified that he has specific access to the system for particular types of materiel. And the other answer is, we have had some problems, but that may be older data taken from their 1986 report.

We think that the situation has improved. It is under steady improvement at the present time.

Chairman GLENN. When will the system be working so that we can depend on the Pentagon being able to know, within reasonable certainty, what material and equipment has been provided to contractors? When will we know if there is a surplus of metal sheeting of a certain type at one contractor that is needed at another so we do not have to go out and buy a whole new supply of it?

That is our problem right now with a lot of this material, and has been for 20 years.

Mr. REAY. Yes, sir. That is exactly right. If I could make one point that has not really come through in the testimony of the prior witnesses this morning and that is, the difference between accountability, which Dr. Costello was describing a few minutes ago, and visibility.

The Department is aggressively moving to get the maximum amount of visibility of material at the contractor's plant. This is the feedback of information coming into the supply system so that we can make the right kind of decision. That is a different kind of reporting than accountability, which is the individual who actually signs for the physical control and physical management of the material.

So we are trying to move on both areas, not just accountability or not just visibility. I think there was a big emphasis in the statements earlier about who has accountability, meaning who signed for the item. We are paying the contractors to sign for the items that they have in their custody. That is a part of the contract provisions.

At the same time, we are trying to develop at each Service and with the Defense Logistics Agency the capability to have as close to real-time feedback of asset visibility as we can. There are a number of examples of systems in the Services where we are putting that capability in place.

Chairman GLENN. How much do you follow-up on what the services' uses are of the equipment and things that they requisition? Do you have a record of that? Do you follow-up on that, as to what their supplies are at any particular time?

Dr. COSTELLO. That is really their responsibility. That is an operational responsibility. We would not have the total staff to do that. This management is done through the contractor, at their own facilities.

Chairman GLENN. I presumed that was the case, but I would like your comment on this circumstance if you know anything about it. This is a very important one to me.

Supplies were sent to the Contras, and these supplies were cut off by the Congress. Now, we could debate that one all day. We also heard that some of the troop deployments to that part of the world were used as a way of getting materials and equipment to the Contras that certain Executive Branch people thought were needed by the Contras but were excess to what Congress authorized. When the troops came back, they just happened to leave some of that equipment there that the Contras got.

Now, that concerns me in this present deployment. What will be the policy with regard to property brought into Honduras on this current deployment? Is the Department of Defense prepared to represent that the Contras will not be given the supplies this time?

Dr. COSTELLO. I do not think it has been the intent under any circumstances to leave material down there, say, in a covert fashion. If I were a battalion commander, I am sure, Senator, and we were responsible for certain amounts of materiel when we left, we would have to have it when we returned. Those accountability procedures are still in effect as far as I know.

Chairman GLENN. Well, I do not know. It would be pretty easy to arrive back at Fort Ord and say, well, that material got expended in the jungles in Honduras while we were on this manuever with Honduran troops. It would seem to me, they could also say the material was lost down there some place and just happened to be found by the Contras.

I am not saying that is the case, but I am asking if there is a policy that all material taken down there will be brought home?

Dr. COSTELLO. That is the policy. I am sure with some consumables, you have to make allowances. You may decide not to bring your loaves of bread back with you. You may decide to leave something like that there.

Chairman GLENN. The bread is going to get stale pretty fast. I am not talking about bread. The Administration fought against the humanitarian things that some of us wanted to send down there such as food and clothing and things like that.

I am talking about war-making material.

Dr. COSTELLO. The policy is that material taken down there that belongs to those forces should return with those forces.

Chairman GLENN. Okay. All right.

I still have trouble, I guess, with this idea that the contractor is going to be the final repository of information regarding what they have and do not have. As I understand it, what you are saying is that we will send material, that it will be accounted for when it is sent to them, but the contractor will have the final tally sheet, if you will, on what we really have. We will be, in effect, following what the Navy has been doing for a long time when they send things for overhaul, and then they ask the contractor what is in his plant so they can bring their records up to date.

I might add, we had about a $460 million variation between what the Navy thought they had sent at one time and what the contractors reported back, and so the Navy just expensed that. The Navy wiped it off the books because the contractors said they did not have it.

Are we to see more examples of that in the future? How are we going to prevent that?

Dr. COSTELLO. I think we have to take a specific look at the details of accountability. If the contractor has it property accounting system, he has to be able to show us how that material was used or incorporated into a ship or for whatever it happened to be used.

Chairman GLENN. But how do we know what they have if we are not keeping records on what we sent to them?

Dr. COSTELLO. Well, first of all, we have said, we have investigated and audited his property accounting system. I happen to be have experience on other side. I remember government people coming around and asking for the details of our property accounting system. So once you have a satisfactory and approved property accounting system, you can account for everything you receive. You account for where everything is and you account for the disposal of everything.

The contractor has the process to account for that material. Unless we want to have total duplication, which we think would be difficult to implement and certainly counterproductive, we are going to hold the contractor accountable for maintaining this accounting system. But we will audit that system as appropriate.

Chairman GLENN. Do you know of any other large business that operates on that basis where we just ask the customer to tell us what he has? Anybody? GM? Ford? GE? Westinghouse?

Dr. COSTELLO. Well, we are getting into what do we want people to do now.

Chairman GLENN. That does not answer my question. Do you know of any other big businesses that operate this way? That is the question.

Dr. COSTELLO. I do not think the material is quite that free. Number one, we first approve the contractor's system. The contractor will account for the material received. He will account for the disposition of that material. He will also be able to have records to tell us where it is in between.

Chairman GLENN. Does any big business, though, do that, use that as a method of running their business?

Dr. COSTELLO. I will say it depends. I think that is too open a question. I can say yes, I think big business does. At General Motors, we used to send material to a supplier, maybe one of our own divisions, and we would say, we sent you so much material. We have an accounting system that says we sent you so much.

The division had to carefully follow and monitor and record the disposition of that material once they have it in their hands. That is what we are holding the contractor responsible for, even today.

Chairman GLENN. When the Navy was at our previous hearing, we got into this in some depth, and on materials sent for overhaul, for instance, the Navy did not know what was sent. As I said a moment ago, they had to wipe about 460 million dollars worth off the Navy's books because what they thought they had sent to contractors for repair was not at the contractors.

Now, there were huge errors obviously. Nearly half a billion dollars worth of somebody's error on what the Navy thought was they sent to contractors and what the contractors said they had. Now, that is too big to just wipe off the books, it seems to me. The Navy said it had approved the accounting systems of those contractors so it felt the contractors' figures were accurate.

That is the same answer you gave me just now. My response was this, when you have a truck shows up at the loading dock out there with X number of instruments on it, how do you know that some dishonest employee does not load up a pickup truck and drive off with it? You do not know, because we are depending on the contractor's accounting system, and it never got logged into the contractor's system because, in effect, it never arrived.

How do you protect against something like that? These are not small nickel and dime items. It just seems to me that there has to be a tighter control than just relying on the contractor. We have had some pretty sad experiences with some dishonest contractors over the past few years.

Now, I am a big supporter of the contractors, basically. And I do not believe in castigating all contractors. Most of them are out there trying to run a good business and make a reasonable profit, and are not trying to rip off the Government. Every contractor, every defense contractor, is not a crook and I am a supporter of defense contractors.

But I want to set up a system where we can detect those few bad apples out there that are ripping us off for billions of dollars. It would seem to me that what we are setting up is not a system that would catch that.

Mr. **Reay**. Sir, I think we would strongly disagree that we are not setting up a system that will properly manage this process. Now, you have made several points. The first point which we need to try to address is this idea of what happens if somebody comes in and they steal something, what are we doing about it?

We would not certify a contractor system unless it had some very detailed procedures to maximize security of the property in the contractor's hands. In fact, every single contractor employing more than one or two people has such a system. I think the problem we have is that there are always going to be dishonest people and we maximize what we need to do to prevent that.

But let's go back to what I think is more central to the point and that is, how does the system work in terms of the relationship between the contractor and the Government. First of all, I think we need to clarify that in terms of the material that is in the hands of the contractor, we know by every single contractor DODAC, which is the contractor address activity code, what we have given the contractor and what their requirement is. So we have that capability to see what the contractor has.

The chart [1] that you have on display up here is a good example that we do know of what is in the hands of the contractors. We fully agree that system needs improving and we are improving it.

Chairman **Glenn**. Let me ask, the chart [2] we had previously up there with the long supply was one that started our investigation on this before the last hearing. Long supply is defined by Defense as the items for which there is no need now and no known need in the future, basically.

We keep this long supply, and we pay storage costs on a lot of it.

The point is from 1980 to the end of 1986, we have gone up some $20 billion in long supply items at a time when we have been trying to get money for other purposes. Now, certainly it would be hard to sell me on the idea that it took 6 years to see that our long supply items should not go up at a faster rate than our whole overall acquisitions. The fast build-up of long supply just shows that we have a permanent percentage built in of waste and potential abuse that is well beyond what I think it should be.

Dr. **Costello**. On the long supply items, the chart shows items for which there is no use for one year. We may have significant use beyond a one-year period of time. We have also instituted programs that will not dispose of anything for which there is a need in an active weapon system, and it may be that we have changed the number of active units using that particular device out in the field. So as we introduce new systems we may see a substantial portion of material in that long supply category. Although the needs may have been decreased because of less use in the field.

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[1] See chart on p. 199.
[2] See chart on p. 198.

Chairman **Glenn**. Will it continue to be our policy for the contractors around the beltway here, or other places across the country, that we will continue to supply them their office equipment and TV, and in some cases cars, et cetera——

Dr. **Costello**. The answer is no.

Chairman **Glenn** [continuing]. As part of their contract?

Dr. **Costello**. We have worked with the IG on this. In fact, we asked the Inspector General to go out and make that survey for us and work with us specifically in that area. We have also asked the IG to help us in broadening that review in other regions as well.

Chairman **Glenn**. The specific examples—and I will not repeat them because we already used them this morning earlier in the testimony, but I am sure you heard them—they are pretty horrendous examples of poor judgment. People just assumed that their contract permitted them to buy whatever they wanted and be reimbursed by DOD. They requisition it, or they buy the equipment and even charge a fee for buying it.

Now, is that sort of thing going to continue?

Dr. **Costello**. No. In fact, we are recovering those fees as they are identified. We have an active program in that area.

Chairman **Glenn**. Well, testimony this morning indicated that this is pretty wide spread, that they feel this is not just the beltway bandits around Washington here, as they are called, rightly or wrongly. Once again, I should not use that term because a lot of these people are doing very good vital work for the Government. But we have a few bad apples that are ripping us off.

The same thing applies to other contracts, I think, across the country.

Dr. **Costello**. The policy states that if it is generally commercially available material and not unique to the contract, the contractor should provide it.

Chairman **Glenn**. Mr. Kordes, do you have something to add to that?

Mr. **Kordes**. What Mr. Vander Schaaf had talked about as far as the other plant equipment, the beltway bandit study that was done, as Dr. Costello said, we requested that because we felt there were problems around the beltway in these type of service contractors, educational contractors. We have fully concurred in all their findings and they are being implemented now.

We then went on to what your concern was; it is not just here in the Washington area but it is also elsewhere. We agree with that and the IG is going to go, at our request, to other parts—to Boston, to Los Angeles—to other parts of the country, because our policy does not allow for profits on government equipment. We want to find where they have been allowed and recover these unallowable profits.

Chairman **Glenn**. Well, let me just read this. In 1980, DOD admitted it needed a financial control system to account for GFM. Fine. Great.

In Mr. Vander Schaaf's testimony he indicates these systems are not in place—here we are 7 and nearly a half years later—and that even when operational, the Navy and Air Force concepts do not meet the principles and standards for such systems. GAO also feels that they are minimally acceptable for this.

And he also stated, and I quote: "The extent of cooperation by the services remains suspect."

And he also states: "GFP in the hands of contractors continues to increase and DOD property management remains a low priority."

You have to require a change in the way the services operate. Do you agree with his analysis, first? And if so, what are you going to do about it?

Dr. **Costello**. I think he was at least complimentary, saying that we have started to put the systems in place. The systems as defined are good. I am looking at Jim Kordes and he has a council that looks at the implementation and the Service's follow-up on our policies.

Jim, you might want to comment on the activities you have there.

Mr. **Kordes**. We did have a problem starting in 1981 and not that much was done to implement the policy or to find out what was being done to correct it. In 1985 we began looking at it in great detail and with resolve came out in 1986 with a policy iterating the policies that were in existence and new ones that were needed to get the job done. We have established. Dr. Costello, signed the follow-up tracking mechanism with the Services to assure that the policies do get implemented.

We have just recently signed a memorandum out to get the milestones established.[1] As you discussed earlier this morning, it is necessary that we get milestones. We agree. We need those milestones and we have asked for detailed milestones from the Services for anything that is not going to be completed by the end of 1988. We plan to continue that kind of tracking to get the job done now that the resolve has been taken and we have the policy on the street.

Chairman **Glenn**. Well, we have the 1986 letter from your predecessor indicating that Government furnished property in the hands of Defense contractors was increasing despite DOD efforts to reduce it. That was in 1986. Now, maybe the new system was not in being then. But that letter also calls for the disposal of obsolete property. Disposing of absolete property is fine, but we have indications that the Army has disposed of hundreds of pieces of earth moving equipment in serviceable condition in order to completely re-equip the Army.

Do you review things like that? Is that part of your mission?

Mr. **Kordes**. That 1986 memorandum was the beginning of putting some discipline into the system to assure that the Services do implement the policies that are out there. The property council that we have with the services and OSD goes into great detail on those policies to implement them. The specifics on earth moving equipment become a responsibility of the Service. But we do see what they are doing.

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[1] See p. 176.

Dr. **Costello.** We have asked for a detailed report.

Chairman **Glenn.** We have dozens of reports, I guess, going back over nearly two decades, some 20 years, looking into the monitoring of defense supplies and how they are controlled after we get them. One example, though, that brings it just up to date is the OPE growth, which is estimated to be somewhere around 2 billion just during the 1980s.

Now, what does that example say about our policy to reduce OPE, which you commented on a moment ago?

Mr. **Kordes.** That is correct and that was one of the things that we recognized when we started and doing this triggered us to come out with the 1986 policy. It was recognized that growth was there. OPE was one of the major ones and that is why we asked the IG to do this beltway bandit review, because of this increase in OPE and also with service contractors.

If I could elaborate on that other chart that was up there, the visibility system. We did not have that until late 1986. If we had appeared here in 1985, we could not have told you how much property we had by different classes. We can tell you that now and we also have management visibility by contract number so we can display—and that is part of our statement—what type of contract, where the property is being provided; educational contracts, RDT&E.

With that we have management visibility where we can start taking direct action, but prior to 1986 we did not.

Dr. **Costello.** I think as a professional in the field of materials management, the proper focus has to come from the top, from my office. And that is why I am probably more comfortable coming to talk about inventory management than perhaps other people that have been here before.

Jim Kordes and Jim Reay and I have had many discussions when I was the Assistant Secretary for Production and Logistics and I carry on that perspective today. The groundwork has been laid implementing and getting them fully operational. Playing catchup on an inventory program is a very difficult task and I think that it has been obvious to the Services and the other people around.

Further than that, we also have the problem of interfacing the computers. I happen to have had some experience in data processing before. Getting computers to talk to each other when everybody has done their own thing has also been a difficult task. It is one of the ways, in order to achieve that oversight, that will be readily available to us.

Chairman **Glenn.** Well, let's say you have perfect programs in place. Let's say they are ideally situated to this biggest business in the world.

You can have the most perfect policies. We can have FARs, Federal Acquisition Regulations, that are perfect. But unless this gets downhill to the people implementing it, it does not mean a hill of beans. We can satisfy some of the critics here in Congress, including myself, to some extent by making sure that the regulations are out there. I have asked every witness whether the FAR needs to be revised.

We can have all those regulations and policies as perfect as they can possibly be. But unless we have people downhill that really know their careers are on the line as on properly implementing what you put out, it is not going to make a hill of beans difference.

Dr. **Costello.** I think there are two aspects to that.

Chairman **Glenn.** Now, why aren't they doing it? Because everybody has testified also that the rules and regulations are not all that ridiculous right now. They need some fine tuning, maybe, but not general overhaul. Nobody has testified to that.

Dr. **Costello.** One of the efforts that we have is to improve the qualifications of the workforce and not just to say today you are going from an administrative category to a professional category. You also have to change the jobs to ensure that property management gets the recognition it should have. It has not had recognition that we think it should have.

When you have a $51–$52 billion inventory, it takes professionals to run it. We want to insure that we have the right resources and the right recognition for those professionals, and the right training.

Chairman **Glenn.** I know, but if you pin it on that, Dr. Costello, we are going to be waiting another 20 years here, long beyond my time in the Senate, to get recognition for somebody as a means of getting something done. We either have rules they are abiding by to carry out their job or we do not. And if we do not have that, we ought to get rid of them and get somebody in there that does.

Dr. **Costello.** That is why we have put a council together under Mr. Kordes' direction to review and monitor the Services' performance on these key issues; to ensure the policies are in place: and to ensure the record keeping is accurate and meets the requirements that we have.

Mr. **Kordes.** We are requiring each person involved with property to have their performance standards include what they are doing and that they be held to it, which is the first time this has been done.

Chairman **Glenn.** Do you think the procurement regulations, FAR, need revision? And if so, what?

Mr. **Kordes.** No. There are some minor things that need to be done. We have some things on the table now with the DAR Council to make some small revisions. Basically, the policies are sound, as the IG and the GAO have testified.

We do have to tighten up some of the loopholes on providing property that are there. That is being done. Those DAR cases are there.

We will be incorporating the changes that were recommended by Mr. Vander Schaaf in the beltway bandit study for other plant equipment to tighten up that control. We think, in agreeing with you, that it should be common sense, but common sense has not prevailed, so we are going to regulate the way we display it in contracts. It will be displayed by item before it is purchased.

Dr. **Costello.** We also think that further emphasis on property management in administrative contracting offices is key. The services, as well as the agencies, are working on that today.

Chairman **Glenn**. Now, you are talking about property management and equipment and materials management at each plant. Let's say we have a giant defense plant. That plant sends in a request and they say, we need X thousand tons of stainless steel of a certain quality, cut a certain way, and stockpiled at our plant because we have our upcoming production. You agree with that; and we send it to them and they use some of it along the way.

Their estimates are not always perfect, and later they request more. We may grant them more, and then they wind up with a surplus. Meanwhile, the same steel is needed in another part of the country someplace.

How are we going to know that? How are we going to know that they have a surplus? We do not even know what they were given.

Dr. **Costello**. I am going to let Jim Reay answer because that is what the new program is going to do specifically for us.

Chairman **Glenn**. Well, when you answer that question, would you also respond on whether the Navy is going to change their supply system to correct the problem where they have X widgets show up on a contractor's dock, and if somebody steals some of them, we do not even know it.

Is that going to be covered now?

Mr. **Reay**. Yes, sir.

Chairman **Glenn**. Tell me how.

Mr. **Reay**. The key is to identify to each contractor what they have and what they need. The system we are putting in place right now by contractor, and where appropriate, by contract number if it is multiple contracts, that information to be fed back into the DOD supply system. This is part of the job that the MCA activities that we talked about before will accomplish in terms of regulating the access to the supply system. The contract administrators at the contractor's plant are also responsible to maintain this control.

The problem we have had up until now——

Chairman **Glenn**. Say that again now so I can get it.

Mr. **Reay**. Keeping control of how the contractors access the supply system in terms of what they order, quantities and so forth, that is the job we are giving to these MCA activities. We are finally able to technically give them the tools to do their jobs.

One of the witnesses earlier testified about the fact the MCAs had not been very effective. Very simply, the reason they have not been effective is that we have not really had the systems to give them the information to do their jobs. In addition to that fact, control was not properly emphasized from a management point of view. That part is being fixed.

In terms of visibility, the other question is, what do the contractors already have? We are developing and have the capability to have visibility back into the Government's system of what each contractor has at the appropriate level of detail.

Chairman **Glenn**. Well, okay. That sounds like it is improving. But still, let's say that I send a thousand steam gauges or altimeters or whatever out to be overhauled.

Now, we do not even keep records on what was going to the contractor for overhaul. Instead, we depend on the contractor to tell us how many he had after it gets there. We do not even keep records on that, apparently, which seems a little ludicrous to me.

Now, will the new system alter that? Mr. Costello said we are still going to depend on the contractors; is that correct?

Mr. REAY. No, sir. What he was referring to is maintaining accountability once the contractor has the material. This is why I make the distinction between accountability and visibility. To use the Navy's example, actually a couple of years ago they started the first increment of what we call our Contractor Asset Visibility System, the CAV1 system, I believe it is called. It was a somewhat rudimentary system to get quick visibility of what was in the contractors' plants.

The Navy is in the process now of upgrading that visibility system to be, in effect, a real-time system so we have almost immediate visibility. This is where we will get the capability to make sure that we are not out making buys at the same time we have some excess material at the contractor's location.

Chairman GLENN. Well, that is what our system has to do, and I cannot imagine any big company—and you are the biggest business in the world, I agree with that—not knowing what it has available. Otherwise, it is going to have enormous amounts of waste. That is why I just took such solid exception to what the Navy was doing with regard to sending material for overhaul and then depending on the contractor to tell them what they have. Then, when the Navy's figures did not agree with what the contractor said, we wiped $464 million off the books.

Mr. REAY. Sir, I think I would like to address that $464 million. You are exactly right when you say the Navy dropped that off the books. We were very concerned. The whole supply process in the Department, including the Navy supply folks, were very concerned about that finding.

We did a follow-up review of that dropping of the $464 million off contractor records. It turns out that what we are talking about is a 15-year accumulation of information that developed during the time when mostly we had manual records. The DOD had to make a decision that we needed to reconcile a set of very old records that had accumulated over the past 15 years with the current data that we had coming into our new system. So we made that decision to make that adjustment.

Now, one point I would like to make. We asked the Defense Contract Audit Service to go out and do a sample check of how much material did we really lose, because there is a big difference, as you well know, between an accounting adjustment and losing material.

They did a sample of 200 items there at the Ship Parts Control Center where this action was taking place; 199 of those items which were in the hands of contractors monitored by SPCC; 199 out of 200 had their records correct.

Chairman GLENN. Well, how would we know even what was sent to them originally if we did not keep a record on it? We would not know what to compare it with.

Mr. REAY. Sir, you are talking about a time when we had manual records going clear back to the early 1960s.

Chairman GLENN. Well, I am told by staff that one contract accounted for $48 million, which was a large part of that total. Five of the contracts accounted for half of the total adjustment and no audits were done, according to the Navy; is that correct?

Mr. **Reay**. I do not know what Mr. Ryan means by no audits. The specific check that I am talking about was a sample check by Defense Contract Audit Service of 200 items, which was kind of a verification check that we were not losing a lot of inventory.

I think what the point was, there were not major audits done of the complete process of that overall transaction.

Chairman **Glenn**. Well we could go on into the details of this ad infinitum.

There is only one other area I want to get into, and that is where you have consumables. That category has caused me some concern.

What do you do with paint and other consumable items that are ordered in large amounts? Are we tightening up on what is issued?

I am concerned about service contracts and operation and maintenance contracts, which are not small items. They are big ticket items now with billions of dollars being spent on them. Yet on many of those contracts, contractors can requisition all of the supplies they want from DOD's supply system. They are requisitioning consumable material and putting it in their warehouses.

How do we control this? Do we have some local person in the command that monitors that to see that we are not getting ripped off?

Mr. **Reay**. Sir, it is a combination of things. First of all, let me say that the bulk of the dollars that we are talking about in terms of service and maintenance contracts are used at what we call the wholesale level. The system that we described a few minutes ago about really tightening down in terms of what the contractor can access, how much and by contract; the first implementation of that system is going to be at the wholesale level.

So the activities that we have put in given the responsibility to monitor that, these MCA activities, will be able to look clear down to the very stock number, whether it is a paint brush or a ream of paper or whatever, and determine whether that is a valid requirement.

The policy, as we have said on a number of occasions—and I think the early witnesses said—the policy is that we basically do not give out that kind of material—paint brushes and paper and whatever. The other side of it, however, is that there are cases where it is appropriate to do that.

For example, a person that has been hired to paint one of the DOD buildings and there are paint brushes in the DOD supply system, the local contracting officer may make a decision that because we have already made the investment in paint brushes, I will supply them. Where the system gets into trouble is the quantities.

Now, if I give a man five paint brushes, that is one thing. If I give him 100, that is questionable. And we fully agree that those are the areas we need to tighten up on.

One of the problems we have, the example where the paint brush came from was down at Eglin Air Force Base. That is what we call a retail activity. Let me contrast it for you. We have 30 major supply depots that are the big suppliers of materiel in DOD. That is where the bulk of the dollars are and that is where the majority of our control process is being applied.

We have literally hundreds and, maybe thousands, of what we call retail activities that are very small supply shops, in some cases one or two people running them. There is where we are going to get the horror stories. We are going to tighten up on those, but I think there is a question of priority application of resources to make sure we get to that.

Chairman **Glenn**. I would not disagree with you on that except rather than supplying paint brushes that have a mil spec and then they are put out for bid and so on, I would submit that the average contractor can go down to Sears and buy a number 4 paint brush a lot cheaper than you are going to procure it through a mil spec through the Pentagon.

Dr. **Costello**. And we agree. Most commercially available items should be supplied by the contractor and that, again, is the policy, and has to be the policy.

Chairman **Glenn**. Okay. Well, we want to follow this very closely, obviously, and we want to follow your efforts in this regard.

I still question this reliability on the contractor for some things. I think maybe you have a lot more trust in contractors than I do. I trust 99 percent of them, but every once in a while there is going to be a big bad apple, and we need to have a system that prevents that big bad apple from having an undue effect on everything else.

Dr. **Costello**. Unfortunately, we still need the auditors and we still need Inspector General capabilities. Not everybody does work the way we want them to.

Chairman **Glenn**. We do, and I agree with that. But also, it seems to me, in any well-ordered operation, big though it may be, we have to know what we are sending to people and what they are using it for. We also must know what is surplus and know where we can use it someplace else if we are going to make the best use of every defense dollar.

Dr. **Costello**. And that is the goal of the systems we are introducing at the present time.

Chairman **Glenn**. Good. We will be following it. Please let me know if you have anything you want us to help you out on here at this end of the avenue. Next time I hope I do not have to be as confrontational in my comments as I have this morning. I hope the system works and I hope you get it operating quickly. I am only sorry it has not been in operation for a long time now.

We have been needing improvements for a long, long time and so whatever assistance you need to push this on downhill, let me know. I would be quite happy to talk to the heads of the services or the Secretary or anybody else about seeing that the system you have gets some emphasis.

We cannot get money for certain aircraft or carriers or O&M or whatever at the same time we see the long supply and these other items here that promote fraud, waste, and abuse. That trend has to be reversed.

Thank you. The hearing will stand in recess subject to the call of the Chair.

[Whereupon, at 12:15 p.m., the Committee adjourned subject to the call of the Chair.]

APPENDIX

STATEMENT BY
DEREK J. VANDER SCHAAF, DEPUTY INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
U.S. SENATE
ON
GOVERNMENT-FURNISHED PROPERTY
IN THE HANDS OF DOD CONTRACTORS

85-979 129

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU THIS MORNING ON THE TOPIC OF GOVERNMENT-FURNISHED PROPERTY (GFP) IN THE POSSESSION OF DEPARTMENT OF DEFENSE CONTRACTORS. I WELCOME THE COMMITTEE'S INTEREST IN IMPROVING THE STEWARDSHIP OVER GFP. WITH AN ESTIMATED $51 BILLION OF DOD PROPERTY CURRENTLY IN THE HANDS OF CONTRACTORS, I BELIEVE YOUR CONCERNS ARE WELL PLACED. I WOULD ALSO NOTE THAT THE PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY (PCIE) HAS FOUND GFP MANAGEMENT PROBLEMS THROUGHOUT THE FEDERAL GOVERNMENT. THESE PROBLEMS ARE NOT LIMITED TO THE DOD.

TOO MUCH GFP

THE MANAGEMENT OF GFP--INCLUDING LAND AND BUILDINGS, INDUSTRIAL PLANT EQUIPMENT, SPECIAL TEST EQUIPMENT AND SPECIAL TOOLING (ST/STE), AND MATERIAL--HAS BEEN A RECOGNIZED PROBLEM AREA FOR DECADES. DESPITE COMMENDABLE RECENT INITIATIVES, PROGRESS HAS BEEN SLOW IN CORRECTING GFP PROBLEMS, AND WE NEED TO SEE MORE RESULTS.

FIRST, THERE IS SIMPLY TOO MUCH PROPERTY BEING FURNISHED UNNECESSARILY. THE FEDERAL ACQUISITION REGULATION (FAR) PART 45 ESTABLISHES THE GENERAL DOD POLICY THAT CONTRACTORS WILL FURNISH ALL PROPERTY REQUIRED FOR THE PERFORMANCE OF GOVERNMENT CONTRACTS. THERE ARE BROAD EXCEPTIONS IN THE FAR, THAT ARE MORE THE RULE AND PRACTICE THAN THE EXCEPTION.

IN THE 1940's, THE GOVERNMENT BEGAN PROVIDING PROPERTY TO SUPPORT WORLD WAR II MOBILIZATION. MANY CONTRACTORS SIMPLY DID NOT HAVE THE NECESSARY RESOURCES TO PROVIDE THE BUILDINGS, EQUIPMENT AND MATERIAL. THE PRACTICE CONTINUED AND, BY THE SIXTIES, THERE WERE INCREASING CONCERNS ABOUT THE AMOUNT OF GOVERNMENT-OWNED PROPERTY WITH CONTRACTORS. IN 1970, DOD INITIATED A POLICY TO PHASE OUT, OVER FIVE YEARS, ALL GOVERNMENT-OWNED FACILITIES IN THE POSSESSION OF CONTRACTORS. THIS EFFORT, CALLED THE "PHASEDOWN POLICY," WAS NOT SUCCESSFUL AND THE AMOUNT OF GOVERNMENT-OWNED PROPERTY HAS CONTINUED TO INCREASE, PRIMARILY BECAUSE DOD HAS NOT MADE A SERIOUS EFFORT HISTORICALLY TO ENFORCE THE POLICY AND NEVER KNEW HOW MUCH GOVERNMENT PROPERTY WAS IN CONTRACTOR'S FACILITIES. FOR EXAMPLE, IN FY 1985 THE ACQUISITION COST OF THIS PROPERTY WAS AN ESTIMATED $10 BILLION. ONE YEAR LATER THE ESTIMATE HAD GROWN TO $45.2 BILLION AND AS OF LAST SEPTEMBER THE ESTIMATE STOOD AT $51.3 BILLION. MUCH OF THOSE INCREASES WAS DUE TO PREVIOUSLY INCOMPLETE REPORTING.

MANAGEMENT PROBLEMS

NUMEROUS INSPECTOR GENERAL, GENERAL ACCOUNTING OFFICE, PCIE, AND SERVICE AUDIT AGENCY REPORTS HAVE DOCUMENTED THE SPECIFIC PROBLEMS IN CONTROLLING GFP. THOSE REPORTS HAVE REVEALED CONTINUING DEFICIENCIES SUCH AS IMPROPER ACQUISITIONS, EXCESS

PROPERTY, LACK OF MATERIAL ACCOUNTING CONTROLS, UNALLOWABLE PROFITS AND FEES, LACK OF TIMELY DISPOSAL, AND INADEQUATE PROPERTY ACCOUNTABILITY. FOR EXAMPLE:

-- CONTRACTORS HAVE CHARGED THE GOVERNMENT FOR EQUIPMENT ACQUISITIONS WITHOUT CONTRACTUAL AUTHORIZATION OR CLEARANCE BY DOD CONTRACT ADMINISTRATING OFFICIALS.

-- CONTRACTORS HAVE OBTAINED, AND FAILED TO REPORT, GFM IN EXCESS OF PRODUCTION NEEDS.

-- ALSO, AFTER PRODUCTION CONTRACTS HAVE BEEN COMPLETED, SPECIAL TOOLING AND SPECIAL TEST EQUIPMENT HAS BEEN RETAINED, INCURRING UNNECESSARY STORAGE COSTS.

-- MUCH OF THE SPECIAL TEST EQUIPMENT PURCHASES IS NOT SPECIAL OR ONGOING AS REQUIRED BUT IS STANDARD COMMERCIALLY AVAILABLE ITEMS THAT ARE CONFIGURED "HOOK TOGETHER" TO PASS THE UNIQUE TEST.

-- BOTH GAO AND THE OIG HAVE FOUND EXAMPLES WHERE CONTRACTORS HAVE EARNED UNALLOWABLE PROFITS WHEN ACQUIRING EQUIPMENT FOR THE GOVERNMENT'S ACCOUNT.

-- SOME CONTRACTORS AND DEFENSE OFFICIALS ARE NOT TAKING TIMELY ACTION TO DISPOSE OF PROPERTY DECLARED EXCESS TO GOVERNMENT NEEDS. FOR EXAMPLE, CONTINUED RETENTION OF INACTIVE GOVERNMENT-OWNED CONTRACTOR-OPERATED (GOCO) PLANTS CAUSES ONGOING UNNECESSARY EXPENDITURES.

-- RECENT OIG, GAO, AND SERVICE AUDITS HAVE DOCUMENTED CONTINUING DEFICIENCIES IN THE CONTROL AND MANAGEMENT OF GOVERNMENT PROPERTY BY BOTH CONTRACTORS AND DOD. CONTRACTORS HAVE FAILED TO MAINTAIN THE NECESSARY INTERNAL CONTROLS OVER GOVERNMENT PROPERTY. IN EACH CASE, THE DOD COMPONENT RESPONSIBILITIES FOR PROPERTY MANAGEMENT WERE NOT BEING CARRIED OUT.

-- RECENTLY COMPLETED AND ONGOING OIG AND DCAA AUDITS, AS WELL AS OIG INVESTIGATIONS, HAVE DEMONSTRATED THE RISKS ASSOCIATED WITH THE CONTROL OF GOVERNMENT-OWNED MATERIAL IN POSSESSION OF DEFENSE CONTRACTORS. THESE AUDITS AND INVESTIGATIONS DOCUMENT THAT THE RISKS INCREASE WITH THE USE OF HIGHLY COMPLEX COMPUTER NETWORKS ONCE KNOWN AS MATERIAL REQUIREMENTS PLANNING (MRP) SYSTEMS AND CURRENTLY (RECOGNIZED) AS MATERIAL MANAGEMENT AND ACCOUNTING SYSTEMS. THESE SYSTEMS HAVE NOT BEEN ADEQUATELY EVALUATED OR MONITORED BY THE DOD COMPONENTS RESPONSIBLE FOR PROPERTY ADMINISTRATION.

AUDIT OF GOVERNMENT OWNED-EQUIPMENT SUPPLIED TO WASHINGTON, D.C. AREA CONTRACTORS

SOME OF THESE LONGSTANDING PROBLEMS HAVE AGAIN BEEN DOCUMENTED IN RECENT GAO STUDIES PREPARED AT THE DIRECTION OF THIS COMMITTEE AND OUR CURRENT DRAFT AUDIT REPORT ENTITLED, "ADMINISTRATION OF OTHER PLANT EQUIPMENT BY WASHINGTON, D.C. AREA CONTRACTORS,"--A REPORT WHICH YOUR INVITATION SPECIFICALLY REQUESTED THAT I ADDRESS, MR. CHAIRMAN.

OUR OVERALL OBJECTIVE IN THIS AUDIT, WHICH WAS REQUESTED BY THE OFFICE OF THE ASSISTANT SECRETARY FOR DEFENSE FOR PRODUCTION AND LOGISTICS, WAS TO DETERMINE IF ADEQUATE CONTROLS EXISTED OVER THE ADMINISTRATION OF GOVERNMENT-OWNED OTHER PLANT EQUIPMENT (OPE) HELD BY WASHINGTON AREA CONTRACTORS DOING BUSINESS WITH DOD. THIS EQUIPMENT WAS COMPRISED OF ITEMS SUCH AS OFFICE FURNITURE, COMPUTER EQUIPMENT, AND TELEVISION SETS. WE ALSO EVALUATED COMPLIANCE WITH DOD POLICY REQUIRING A PHASE-DOWN OF EQUIPMENT AUTHORIZATIONS FOR CONTRACTORS. WE REVIEWED 15 OF 77 WASHINGTON AREA CONTRACTORS, WHO REPORTED HOLDING ABOUT $115 MILLION OF THIS EQUIPMENT. (COLLECTIVELY, ALL DOD CONTRACTORS REPORT HAVING $4 BILLION OF OPE.)

IN GENERAL, THE REPORT SHOWS THAT ADMINISTRATIVE CONTROLS WERE INADEQUATE FOR OPE. ALTHOUGH DOD POLICIES HAVE PROVIDED GENERALLY ADEQUATE GUIDANCE FOR CONTROLLING PROPERTY IN THE POSSESSION OF CONTRACTORS, THE SERVICES AND DEFENSE AGENCIES HAVE BEEN SLOW TO RESPOND TO OR HAVE NOT ADHERED TO THESE POLICIES.

OTHER PLANT EQUIPMENT HELD BY WASHINGTON AREA CONTRACTORS NEARLY DOUBLED FROM 1983 TO 1985; ALSO, IN MANY CASES, NEW FURNITURE AND EQUIPMENT THAT SHOULD NOT HAVE BEEN PURCHASED IN THE FIRST INSTANCE WAS "EXPENSED" AGAINST A SINGLE CONTRACT RATHER THAN DEPRECIATED.

WE FOUND THAT 40% OF THE CONTRACTORS IN OUR SAMPLE CHARGED THE GOVERNMENT FOR OPE WITHOUT CONTRACTUAL AUTHORIZATION. WE ARE RECOMMENDING THAT A POLICY STATEMENT BE ADDED TO THE DFARS THAT PROHIBITS CONTRACTOR-ACQUIRED OPE UNLESS EXPRESSLY APPROVED IN ADVANCE AND IDENTIFIED ITEM-BY-ITEM IN THE CONTRACT. WE ARE ALSO RECOMMENDING RECOVERY OF FUNDS PAID FOR UNAUTHORIZED OPE ACQUISITIONS AND THAT THE NAVY COMPLY WITH THE FAR REGARDING CONTRACT AUTHORIZATIONS.

IN A SECOND FINDING, CONCERNING UNALLOWABLE FEES PAID THESE CONTRACTORS, WE SHOWED THAT 53 PERCENT OF THE CONTRACTORS IN OUR SAMPLE WERE AWARDED UNALLOWABLE FEES (PROFIT) FOR ACQUIRING AND USING GOVERNMENT-FURNISHED OPE. WE ESTIMATED THAT $1.1 MILLION IN UNALLOWABLE FEES HAVE NOT BEEN RECOVERED EVEN THOUGH THE NOVEMBER 1986 DOD POLICY MEMORANDUM ON GOVERNMENT PROPERTY SPECIFICALLY DIRECTED SUCH ACTION. WE ARE RECOMMENDING THAT THE SERVICES AND DEFENSE AGENCIES INITIATE ACTION TO IDENTIFY AND RECOVER UNALLOWABLE FEES IN OPE ON OPEN CONTRACTS AND THAT THE ARMY ISSUE GUIDANCE IMPLEMENTING THE DOD POLICIES REGARDING THE UNALLOWABILITY OF FEES ON OPE. LASTLY, WE ARE

RECOMMENDING THAT THE DEFENSE CONTRACT AUDIT AGENCY ISSUE AUDIT GUIDANCE ON THESE UNALLOWABLE FEES.

FINALLY, WE DETERMINED THAT ALL THE CONTRACTORS IN OUR SAMPLE HAD PROPERTY SYSTEM DEFICIENCIES. DOD EMPLOYEES PERFORMING ANNUAL PROPERTY SYSTEM SURVEYS DID NOT DETECT PROPERTY SYSTEM DEFICIENCIES, SUCH AS THE LACK OF RECONCILIATION OF BEGINNING BALANCES WITH THE PRIOR PERIOD'S ENDING BALANCES, AND VARIANCES BETWEEN PHYSICAL INVENTORY RESULTS AND ACCOUNTING RECORDS. AS A RESULT, CONTRACTOR PROPERTY SYSTEMS WERE APPROVED THAT DID NOT ENSURE ACCOUNTABILITY OF THIS HIGHLY PILFERABLE OFFICE EQUIPMENT. WE ARE RECOMMENDING STRENGTHENED PROCEDURES FOR PERFORMING PROPERTY SYSTEM REVIEWS; THAT PROPERTY ADMINISTRATION RESPONSIBILITY BE ASSIGNED TO INDIVIDUALS WITH REQUISITE EXPERIENCE AND TRAINING; AND THAT INTERNAL CONTROL WEAKNESSES BE REPORTED IN THE ANNUAL ASSURANCE STATEMENTS TO THE SECRETARY OF DEFENSE.

ACQUISITION OF SPECIAL TOOLING AND SPECIAL TEST EQUIPMENT

IN A RECENT AUDIT OF THE ACQUISITION OF SPECIAL TOOLING AND SPECIAL TEST EQUIPMENT, WE EXAMINED THE POLICIES AND PROCEDURES FOR ACQUISITION OF ST AND STE RELATED TO THREE WEAPON SYSTEMS AND FOUND:

FIRST, THAT DOD CONTRACTING OFFICERS DID NOT FOLLOW THE CRITERIA IN THE FAR IN DETERMINING WHETHER IT WAS ADVANTAGEOUS FOR THE GOVERNMENT TO PROVIDE ST AND STE TO CONTRACTORS.

SECOND, THE SERVICES' POLICIES ON ACQUIRING ST AND STE DIFFERED. ON 10 CONTRACTS REVIEWED, GENERAL-PURPOSE COMPONENTS AND COMMERICAL AUTOMATIC DATA PROCESSING EQUIPMENT (ADPE), WERE BEING PROCURED WITH DOD FUNDS AS STE BECAUSE OF VARYING INTERPRETATIONS OF THE STE DEFINITION. THIS RESULTED IN DOD DIRECTLY REIMBURSING THE THREE CONTRACTORS ABOUT $32 MILLION, FOR THE EQUIPMENT, INCLUDING OVERHEAD AND PROFIT, INSTEAD OF THE CONTRACTOR FINANCING AND CAPITALIZING THE EQUIPMENT COSTS.

THIRD, RELATIVE TO THE ISSUE OF THE NEED FOR CLARIFICATION IN THE FAR ON WHEN IT IS APPROPRIATE TO PROVIDE PROPERTY FREE OF CHARGE--WHICH YOUR INVITATION SUGGESTED I ADDRESS, MR. CHAIRMAN--WE FOUND NO EMPIRICAL DATA OR PROCESS AVAILABLE TO DETERMINE WHEN IT WAS MORE ECONOMICAL TO THE GOVERNMENT FOR THE CONTRACTOR OR FOR THE DOD TO PROVIDE THE EQUIPMENT.

WE CONCLUDED THAT DOD APPARENTLY CONTINUES TO BUY AND PROVIDE ST AND STE TO CONTRACTORS ON THE THEORY THAT IT IS CHEAPER TO MAINTAIN OWNERSHIP THAN TO REQUIRE THE CONTRACTORS TO CHARGE IT INDIRECTLY TO THE CONTRACTS. ALSO, A PROPOSED CHANGE TO THE FAR WOULD CLARIFY THE DEFINITION OF STE TO INCLUDE STANDARD OR GENERAL PURPOSE COMPONENTS THEREBY MAKING THIS EQUIPMENT ELIGIBLE FOR DOD FUNDING. THIS FAR CHANGE REFLECTS WHAT IS REALLY HAPPENING BUT IS CLEARLY CONTRARY TO THE UNDER SECRETARY OF DEFENSE FOR ACQUISITION'S NOVEMBER 1986 DIRECTION TO THE SERVICES TO REDUCE THE AMOUNT OF GOVERNMENT-FURNISHED EQUIPMENT. DEPARTMENTAL MANAGEMENT ASSERT THAT IF

THE DOD DOES NOT RETAIN THE LIBERAL INTERPRETATION OF WHAT CONSTITUTES STE, OUR CONTRACTORS WILL PRODUCE OR BUY TRULY UNIQUE EQUIPMENT WHICH WILL COST EVEN MORE AND IS NOT REALLY NECESSARY. WE RECOMMENDED SEVERAL ALTERNATIVE COURSES OF ACTION TO THE ASSISTANT SECRETARY OF DEFENSE FOR PRODUCTION AND LOGISTICS TO ADDRESS THESE CONCERNS. MANAGEMENT NONCONCURRED WITH OUR CONCLUSIONS AND RECOMMENDATIONS AND THE MATTER IS PRESENTLY BEING STAFFED IN THE FORMAL DOD AUDIT RESOLUTION PROCESS.

PREVIOUS I.G. AUDITS WHERE MANAGEMENT HAS AGREED TO TAKE CORRECTIVE ACTION

AT THIS POINT MR. CHAIRMAN, I WOULD LIKE TO REVIEW THE STATUS OF AGREED-UPON RECOMMENDATIONS CONTAINED IN OLDER AUDIT REPORTS AND RESPOND TO SOME OF THE QUESTIONS WHICH YOUR INVITATION SUGGESTED WE ADDRESS.

THE AUGUST 31, 1983 DOD OIG REPORT ENTITLED, "GOVERNMENT PROPERTY IN THE POSSESSION OF CONTRACTORS AND GRANTEES," REFERENCED IN YOUR INVITATION, RESULTED FROM AN EXTENSIVE, DEPARTMENT-WIDE AUDIT CONDUCTED BETWEEN JUNE 1982 AND MARCH 1983. THIS WAS A COOPERATIVE EFFORT BETWEEN THE DOD IG AND THE SERVICE AUDIT AGENCIES. THE RESULTS WERE USED IN AN EVEN BROADER STUDY DONE ON FEDERAL GFP MANAGEMENT BY THE PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY.

THE PCIE REPORTED THAT, WITH FEW EXCEPTIONS, DEPARTMENTS AND AGENCIES DID NOT MAINTAIN INDEPENDENT FINANCIAL CONTROLS OVER GOVERNMENT PROPERTY WITH CONTRACTORS AND GRANTEES WHICH WAS ESTIMATED TO HAVE AN ACQUISITION VALUE OF ABOUT $52 BILLION. THE DOD ACCOUNTED FOR ABOUT $33 BILLION OF THE TOTAL. THE REPORT MADE 23 RECOMMENDATIONS TO IMPROVE THE CONTROLS OVER GOVERNMENT PROPERTY WITH CONTRACTORS. DOD CORRECTIVE ACTIONS HAVE BEEN COMPLETED ON 14 OF THE RECOMMENDATIONS AND WORK CONTINUES ON THE REMAINING NINE.

YOUR INVITATION ALSO EXPRESSED INTEREST IN A 1984 OIG REPORT ENTITLED "GOVERNMENT-FURNISHED MATERIAL AT DOD PRODUCTION CONTRACTORS" WHERE LIMITED AUDIT TESTS AT 15 PRODUCTION CONTRACTORS IDENTIFIED ALMOST $25 MILLION DOLLARS OF EXCESS GFM. WE RECOMMENDED A MORE SYSTEMATIC ONE-TIME REVIEW OF GFM AT PRODUCTION CONTRACTORS, IMPROVEMENTS IN DATA SYSTEMS AND REPORTS, MORE COMPREHENSIVE GOVERNMENT PROPERTY SURVEYS, AND THE ESTABLISHMENT OF TIME FRAMES FOR REPORTING RESIDUAL MATERIAL CONTRACTS.

I AM PLEASED TO REPORT THAT, THROUGH OUR AUDIT FOLLOWUP PROCESS, WE HAVE BEEN ABLE TO DOCUMENT THE COMPLETION OF THE ONE TIME REVIEW OF PRODUCTION CONTRACTS WITH GFM OF MORE THAN $20 MILLION. PROBLEMS INDENTIFIED IN THE MANAGEMENT OF GFM WERE NOTED. DOD MANAGEMENT CONCLUDED THAT THEY DID NOT RESULT FROM BAD POLICY OR PROCEDURES, BUT WERE ASSOCIATED WITH LACK OF ADHERENCE WITH STATED POLICIES ALREADY INCLUDED IN CONTRACTORS'

PROCEDURES, CONTRACTUAL LANGUAGE, DFAR, FAR, DEPARTMENTAL INSTRUCTIONS, POLICY MEMORANDA, AND COMPANION REVIEWS. THE LESSONS LEARNED FROM THE REVIEWS AND THE THRUST OF THE RECOMMENDATIONS MADE IN OUR 1984 REPORT WERE INCORPORATED INTO THE COMPREHENSIVE PROPERTY POLICY MEMORANDUM ISSUED BY THE OFFICE OF THE SECRETARY OF DEFENSE IN NOVEMBER 1986. WE CONSIDER THIS MEMORANDUM TO BE THE CORNERSTONE OF DOD POLICY FOR MANAGING GFP.

FINANCIAL ACCOUNTING FOR GFP

I WOULD NOW LIKE TO TURN TO THE DEVELOPMENT OF A FINANCIAL ACCOUNTING SYSTEM FOR GOVERNMENT PROPERTY, AN ISSUE WHICH WAS MENTIONED IN OUR PCIE REPORT AND YOUR INVITATION TO TESTIFY. AN AUGUST 1980 GAO REPORT ENTITLED "WEAKNESS IN ACCOUNTING FOR GOVERNMENT-FURNISHED MATERIALS AT DEFENSE CONTRACTORS' PLANTS LEADS TO EXCESSES," ASSERTED THAT MILLIONS OF DOLLARS WORTH OF GFM WAS BEING UNNECESSARILY BOUGHT. THAT REPORT WAS PARTICULARLY TELLING AND, FOR THE FIRST TIME, LED TO PROFESSED RECOGNITION BY THE DOD OF THE NEED FOR GOVERNMENT FINANCIAL ACCOUNTING CONTROL SYSTEMS FOR GFM. I FEEL THAT DEVELOPMENT OF THE NEW SYSTEMS HAS NOT RECEIVED SUFFICIENT MANAGEMENT EMPHASIS AND DOD EFFORTS HAVE BEEN DISAPPOINTING. SOME PROGRESS HAS BEEN MADE, BUT MORE NEEDS TO BE DONE. ON THE POSITIVE SIDE, THE LATEST IMPLEMENTATION STATUS REPORT PROVIDED TO US BY THE DOD COMPTROLLER INDICATED THAT THE ARMY ACCOUNTING SYSTEM CONCEPT MEETS THE GAO PRINCIPLES AND THE STANDARDS AND REQUIREMENTS OF

THE DOD ACCOUNTING MANUAL. IMPLEMENTATION OF THE ARMY SYSTEM IS SCHEDULED FOR SEPTEMBER 1988. UNFORTUNATELY, THE NAVY AND AIR FORCE CONCEPTS DO NOT MEET THE GAO PRINCIPLES AND STANDARDS. BOTH SYSTEMS PROVIDE FOR POSTING THE AMOUNT OF GFP ON HAND AT CONTRACTOR PLANTS TO THE GENERAL LEDGER ACCOUNTS ANNUALLY BASED ON THE PROPERTY ACCOUNTING REPORTS SUBMITTED BY THE CONTRACTORS. THE NAVY AND AIR FORCE HAVE ASSERTED THAT IT WOULD BE COST PROHIBITIVE TO IMPLEMENT THE REQUIRED ACCOUNTING FOR GFP AND THE COMMITTEE SHOULD ASSESS THEIR POSITION.

WHERE WE STAND

MR. CHAIRMAN, YOUR INVITATION SUGGESTED THAT I GIVE YOU OUR ASSESSMENT OF OVERALL PROGRESS IN DOD TO BETTER MANAGE GOVERNMENT PROPERTY AND WHAT CURRENTLY NEEDED TO BE DONE TO IMPROVE THE SITUATION.

OUR AUDIT FOLLOWUP DATA AND MOST RECENT AUDITING BOTH CONTINUE TO INDICATE THAT GFP PROBLEMS HAVE NOT BEEN RESOLVED, AND THE PROGRESS ON CORRECTIVE ACTIONS IS LIMITED. DESPITE THE AGGRESSIVE IMPROVEMENT PROGRAM DIRECTED BY THE OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE FOR PRODUCTION AND LOGISTICS, IMPLEMENTATION OF THE DIRECTED INITIATIVES BY THE SERVICES AND THE DEFENSE AGENCIES IS JUST BEGINNING. THE EXTENT OF COOPERATION BY THE SERVICES REMAINS SUSPECT. FOR EXAMPLE, ISSUANCE OF SERVICE GUIDANCE AND REGULATIONS, INITIALLY TARGETED FOR COMPLETION IN FALL 1987, HAS SLIPPED IN MANY CASES. THE ARMY, FOR INSTANCE, DID NOT ISSUE AN ACQUISITION LETTER TO

IMPLEMENT THE NOVEMBER 1986 PROPERTY POLICY UNTIL FEBRUARY OF THIS YEAR. TARGET DATES FOR ACTION ON CERTAIN DAR CASES, DRAFT LEGISLATIVE PROPOSALS, AND OTHER ACTIONS REQUIRED TO IMPLEMENT THE NOVEMBER 1986 PROPERTY POLICY, HAVE SLIPPED IN MANY CASES. DELAYED DAR COUNCIL ACTION ON CASE 85-241, TO ESTABLISH SPECIAL TOOLING POST-PRODUCTION CONTROLS, PERPETUATES THE PROBLEM OF STORING UNNEEDED SPECIAL TOOLING. THE AIR FORCE, AS THE EXECUTIVE AGENT, SUBMITTED THIS CASE IN 1985.

AS I STATED IN MY MARCH 1985 TESTIMONY BEFORE THE HOUSE COMMITTEE ON GOVERNMENTAL OPERATIONS, CARE MUST BE TAKEN TO ENSURE THAT THE MILITARY DEPARTMENTS NOT ONLY IMPLEMENT THE DOD PROPERTY ACCOUNTING STANDARDS AND THE RELATED PROPERTY ACCOUNTS, BUT ALSO THAT THE SYSTEM PROVIDES FOR THE BALANCES REFLECTED IN FINANCIAL RECORDS ON GFM TO BE RECONCILED WITH A CONTRACTOR'S RECORDS AT THE TIME OF CONTRACT CLOSE OUT. THIS WOULD PROVIDE AN ESSENTIAL INTERNAL CONTROL DEVICE TO ENSURE THAT ALL GFP IS PROPERLY ACCOUNTED FOR.

THE ACCOUNTING SYSTEMS CURRENTLY ENVISIONED BY THE NAVY AND THE AIR FORCE WOULD ELIMINATE THIS VITAL INTERNAL CONTROL DEVICE. I UNDERSTAND THAT THE DOD COMPTROLLER STAFF SHARES MY CONCERN AND HAS REQUESTED NAVY AND AIR FORCE TO PROVIDE INFORMATION NECESSARY FOR DETERMINING WHETHER THEIR SYSTEM CONCEPTS MEET GAO ACCOUNTING PRINCIPLES AND STANDARDS FOR FINANCIAL REPORTING OF GFM. THE SERVICES WERE ALSO REQUESTED TO PROVIDE AN ESTIMATE OF THE ACTUAL COST TO DEVELOP AND IMPLEMENT

THE ACCOUNTING CONTROLS FOR GFM. SUCH ESTIMATES ARE REQUIRED BY THE DOD ACCOUNTING MANUAL.

THE OFFICE OF THE ASSISTANT SECRETARY FOR PRODUCTION AND LOGISTICS RECOGNIZES THAT IMPLEMENTATION OF THE 1986 PROPERTY MEMORANDUM HAS NOT TAKEN PLACE, THAT GFP IN THE HANDS OF CONTRACTORS CONTINUES TO INCREASE, AND DOD PROPERTY MANAGEMENT REMAINS A LOW PRIORITY AS REFLECTED IN THE LACK OF STAFF ALLOCATED TO THIS FUNCTION. IN MY OPINION, THE DEPARTMENT'S CHIEF ACQUISITION OFFICIAL, MR. COSTELLO, MUST FORCE THE FULL COOPERATION OF THE SERVICES AND REQUIRE THEM TO MAKE CERTAIN NEEDED INVESTMENT IF THEIR MANAGEMENT OF GFP IS TO BE IMPROVED. A HIGH PRIORITY MUST BE GIVEN TO IMPLEMENTING THE NOVEMBER 1986 DIRECTIVE TO REALIGN EXISTING RESOURCES TO PROVIDE FOR ADEQUATE STAFFING OF THE PROPERTY ADMINISTRATION FUNCTION AND TO PROVIDE TRAINING TO ENHANCE MANAGEMENT AND TECHNICAL SKILLS.

SOME SIGNIFICANT STEPS HAVE BEEN TAKEN. HOWEVER, THE HISTORY OF THIS SUBJECT CLEARLY INDICATES THAT, HAD IT NOT BEEN FOR THE COMBINATION OF CONTINUED CONGRESSIONAL INTEREST AND THE PRESSURE GENERATED BY THE DOD AUDIT FOLLOWUP SYSTEM, PROGRESS WOULD HAVE BEEN FAR MORE LIMITED. I AM HOPING THAT THE RECENT INVOLVEMENT OF THE DEFENSE COUNCIL ON INTEGRITY AND MANAGEMENT IMPROVEMENT--CHAIRED BY DEPUTY SECRETARY TAFT--IN THE MATTER WILL HELP TO GENERATE A GENUINE MANAGEMENT COMMITMENT.

YOU ALSO ASKED FOR OUR VIEWS ON WHETHER CONTRACTORS SHOULD CONTINUE TO HAVE RESPONSIBILITY FOR MAINTAINING THE OFFICIAL INVENTORY RECORDS FOR GFM SEVERAL POINTS MERIT YOUR CONSIDERATION. THERE ARE TWO TYPES OF RECORDS WHICH RELATE TO THIS ISSUE, CONTRACTOR INVENTORY RECORDS AND FINANCIAL ACCOUNTING SYSTEM RECORDS. AS PROVIDED IN FAR 45.105, CONTRACTORS ARE RESPONSIBLE FOR ESTABLISHING AND MAINTAINING THE GOVERNMENT'S OFFICIAL PROPERTY RECORDS. THESE RECORDS SHOW THE QUANTITY, UNIT PRICES AND LOCATION OF THE PROPERTY. FAR 45.105 ALSO PROVIDES, WITH CERTAIN LIMITED EXCEPTIONS, THAT DUPLICATE OFFICIAL RECORDS SHALL NOT BE FURNISHED OR MAINTAINED BY GOVERNMENT PERSONNEL.

THE FINANCIAL ACCOUNTING SYSTEM RECORDS, AS DEFINED IN THE ACCOUNTING SYSTEM MANUAL DOD 7220.9-M, WILL CONTAIN GFP DATA BY CONTRACTOR AND INCLUDE THE BOOK VALUE OF GFP SHIPPED, OR OTHERWISE FURNISHED, TO CONTRACTORS AS WELL AS THE GFP REPORTED BY CONTRACTORS AS USED, RETURNED, OR OTHERWISE DISPOSED OF. THUS, TO MAINTAIN EFFECTIVE CONTROL, DOD ACCOUNTING SYSTEM RECORDS WOULD PROVIDE THE SUMMARY INFORMATION ON GFP WHILE THE PROPERTY CONTROL RECORDS AND SYSTEMS OF CONTRACTORS PROVIDE THE MORE DETAILED INFORMATION.

IT IS NOT CLEAR TO US THAT THE CONTRACTOR RESPONSIBILITY FOR MAINTAINING THE OFFICIAL INVENTORY RECORDS FOR GFP SHOULD BE CHANGED. THERE WOULD BE SUBSTANTIAL COSTS ASSOCIATED WITH CREATING A GOVERNMENT SYSTEM FOR MAINTAINING THE OFFICIAL INVENTORY RECORDS. WE ARE AWARE OF NO EVIDENCE TO SUGGEST THAT

SUCH A CHANGE WOULD BE WORTH THE COST. HOWEVER, AS I STATED EARLIER IN MY TESTIMONY, RECENT OIG AND OTHER AUDITS INDICATE THAT CONTRACTOR PROPERTY SYSTEMS HAVE DEFICIENCIES THAT WERE NOT DETECTED BY DOD EMPLOYEES PERFORMING ANNUAL PROPERTY SYSTEM SURVEYS. WE FIRMLY BELIEVE, AND HAVE RECOMMENDED, THAT DOD PROCEDURES FOR PERFORMING CONTRACTOR PROPERTY SYSTEMS REVIEWS SHOULD BE STRENGTHENED AND THAT INDIVIDUALS WITH REQUISITE EXPERIENCE AND TRAINING SHOULD BE ASSIGNED THE PROPERTY SYSTEM OVERSIGHT RESPONSIBILITY AND APPROPRIATE ACTIONS SHOULD BE TAKEN AGAINST CONTRACTORS WHO FAIL TO MAINTAIN PROPERTY RECORDS IN ACCORDANCE WITH CONTRACTUAL PROVISIONS. WE ARE AWARE OF NO INSTANCE WHERE THIS HAS EVER BEEN DONE, EXCEPT WITH RESPECT TO RECENT WEAKNESSES IN THE CONTRACTORS' MRP SYSTEMS.

RELATIVE TO THE FINANCIAL ACCOUNTING RECORDS AND THE DEVELOPMENT OF THE FINANCIAL ACCOUNTING SYSTEM, I STATED EARLIER THAT THE LATEST STATUS IMPLEMENTATION REPORT INDICATED THE NAVY AND AIR FORCE SYSTEM CONCEPTS DO NOT MEET THE GAO PRINCIPLES AND STANDARDS. WE HAVE NOT REVIEWED THE MILITARY DEPARTMENTS' FINANCIAL ACCOUNTING SYSTEM CONCEPT DESIGNS. THE DOD COMPTROLLER HAS THE LEAD IN MONITORING THE SYSTEMS DEVELOPMENT. WHILE WE CANNOT GO SO FAR AS SAYING THAT THE NAVY AND AIR FORCE SYSTEM CONCEPTS ARE ENTIRELY UNREASONABLE, ONE THING IS CERTAIN--WE NEED A UNIFORM ACCOUNTING SYSTEM FOR GFP. DESPITE THIS NEED, THE DOD COMPONENTS HAVE ARGUED ABOUT THIS PROBLEM FOR EIGHT YEARS, AND STILL HAVE NOT DECIDED ON A UNIFORM APPROACH FOR DEVELOPING

THE FINANCIAL ACCOUNTING SYSTEM RECOMMENDED BY GAO. AGAIN AN AREA WHERE THE ACQUISITION EXECUTIVE HAS TO PLAY AN IMPORTANT ROLE.

CONCERNING THE NEED FOR CLARIFICATION IN THE FAR ON WHEN IT IS APPROPRIATE TO PROVIDE SUCH PROPERTY FREE OF CHARGE, ACTIONS ARE UNDERWAY BY OASD(P&L) TO CHANGE THE REGULATION. THE NOVEMBER 1986 OSD PROPERTY POLICY MEMORANDUM RECOGNIZED THAT DOD CONTRACTING ACTIVITIES' IMPLEMENTATION OF FAR EXCEPTIONS HAVE BECOME TOO LOOSE AND ARE PERMITTING THE FURNISHING OF LARGE AMOUNTS OF GFP THAT SHOULD BE PRIVATELY FINANCED. THE CONTRACTORS' INABILITY OR GENERAL RELUCTANCE TO PROVIDE FACILITIES SHOULD NOT BE USED AS THE BASIS FOR THE GOVERNMENT PROVIDING GFP. THE POLICY MEMORANDUM DIRECTED THAT THE FAR BE REVISED TO MAKE THIS CLEAR. ARMY, THE EXECUTIVE AGENT FOR THIS ACTION, HAS INITIATED A CASE TO REVISE THE FAR.

YOU ALSO ASKED FOR MY OPINION ON THE DOD EXPERIMENT IN REQUIRING CONTRACTORS TO PAY FOR GOVERNMENT PROPERTY. SINCE THE SEPTEMBER 1983 REPORT ON THE TEST, NO FURTHER ACTIONS HAVE BEEN INITIATED IN THIS AREA. AS I TESTIFIED BEFORE THE HOUSE COMMITTEE ON GOVERNMENT OPERATIONS IN 1985, I AM NOT CONVINCED THAT THE DEPARTMENT HAS ADEQUATELY EXPLORED THE FEASIBILITY OF IMPROVING CONTRACTORS' INCENTIVES FOR PRUDENTLY USING GFM BY HAVING THEM PURCHASE STOCK ITEMS DIRECTLY FROM THE GOVERNMENT SUPPLY SYSTEM. I PERSONALLY PLAYED AN ACTIVE ROLE IN URGING THE CONGRESS TO PROVIDE THE LEGAL AUTHORITY FOR SUCH PROCEDURES IN 1980, AND TO DIRECT THERE BE A TEST INVOLVING OVERHAUL AND

MAINTENANCE CONTRACTORS. HAD THAT TEST BEEN SUCCESSFUL, THE CONCEPT MIGHT HAVE BEEN EXTENDED TO PRODUCTION CONTRACTORS.

UNFORTUNATELY, THE TEST WAS DEEMED UNSUCCESSFUL. CONTRACTORS APPEARED RELUCTANT TO PARTICIPATE DUE TO PERCEIVED FINANCIAL RISKS TO THEM. ONLY ONE CONTRACT WAS AWARDED AND IT CONTAINED EXTRAORDINARY RISK AVOIDANCE PROVISIONS. IT IS MY PERSONAL OPINION THAT IT IS PREMATURE TO REJECT THE CONCEPT THAT CONTRACTORS WHO ARE GRANTED ACCESS TO THE DOD SUPPLY SYSTEM SHOULD PAY FOR THE MATERIAL THEY REQUISITION. THE METHODOLOGY OF THE TEST, FOR EXAMPLE THE WORDING OF THE GOVERNMENT BID INVITATIONS, MIGHT HAVE DETERRED CONTRACTOR PARTICIPATION. FURTHER EVALUATION SEEMS TO BE NEEDED AT THIS TIME--RATHER THAN REVISIT THE DATA GENERATED IN THE FIRST TEST, I WOULD PREFER TO SEE A NEW TEST, UNDER CURRENT MARKET CONDITIONS, CLOSELY SUPERVISED BY THE OFFICE OF THE SECRETARY OF DEFENSE AND AUDITED BY THE DOD IG.

I WOULD LIKE TO CLOSE WITH AN ASSURANCE THAT THE DOD IG WILL CONTINUE ITS OVERSIGHT AND FOLLOWUP IN EFFORTS IN THIS IMPORTANT AREA. WE ARE CURRENTLY PLANNING A FULL-SCALE FOLLOWON REVIEW IN FY 1989 OR 1990 TO ASSESS PROGRAM PROGRESS. WE ARE CURRENTLY CONDUCTING FIVE AUDITS IN SELECTED GFP AREAS AND PLANNING AN ADDITIONAL EIGHT AUDITS FOR FISCAL YEARS 1988 AND 1989. THE DOD IG AUDIT FOLLOWUP OFFICE IS CURRENTLY TRACKING THE

IMPLEMENTATION STATUS OF 47 OPEN PRIOR AUDIT RECOMMENDATIONS REGARDING GFP. WE WILL CLOSELY MONITOR THE DEPARTMENT'S PROGRESS ON EACH OF THEM.

MR. CHAIRMAN, THAT CONCLUDES MY STATEMENT.

RESPONSES OF RICHARD L. SHAFFER TO WRITTEN QUESTIONS SUBMITTED BY CHAIRMAN GLENN

1. From your perspective, what are the biggest problems in providing government furnished property to contractors? How can they be solved?

Response -- Proper inventory accountability and control is an essential ingredient to efficient and effective management of any large business. The nature and size of the Department of the Navy is such that overall management of our inventory system is a monumental effort. Within the total spectrum of the process that acquires, ships, stores, and consumes such inventory, we are attempting to focus on that facet that relates to provision of Government Property for use by a Defense contractor. Traditionally in this subset of the overall process, the Defense manager has emphasized procurement and delivery of required material more than accurate accountability of the material provided to, consumed by, and held by the contractor. The consequence of this approach is that we get delivery of finished products of sufficient quality to accomplish the mission and provide us with a force structure capability adequate to support our overall National Security needs. But the lack of adequate attention to effective inventory accountability and control has engendered an unacceptable degree of inefficiency within the overall acquisition and operational force structure maintenance programs. In summary, the biggest problem has been the lack of continuing and assertive management attention against the need to properly oversee the provision, storage, consumption and the disposition of contractor excesses associated with the Government Furnished Property (GFP) process.

Through the efforts of Congress and prudent managers within the Defense establishment and a high degree of cooperation from the industrial segment of our national economy, an increased amount of management attention is now being focused on this area. We have now begun to identify specific areas where added management attention can bring about desired efficiencies.

The Naval Audit Service has conducted extensive audits in the area of Government Furnished Material, a subset of GFP, and has identified specific areas which should be fixed. We found that the Navy needs to designate a single point to react to our findings. Based on informal discussions with the Chief of Naval Operations staff, I am confident that such a focal point will be identified. Once that is accomplished we will present our findings and recommendations to that individual. He can then develop a plan of action to remedy the situation and the Naval Audit Service will conduct followup audits to determine if the "fix" was applied and whether the intended results were achieved.

ENCLOSURE (1)

The specific deficiencies we've identified to date were included in my statement. Other areas requiring attention such as financial reporting of inventory value, the need to validate contractor requisitions, and the quality of staff have been identified by either management or other audit agencies. Each specific deficiency can be remedied once the Navy overcomes the major problem of structuring a management approach which is capable of: gathering information, setting specific objectives, prioritizing and correlating proper action, ensuring that appropriate attention and resources are applied, and overseeing the process to ensure the intended results are achieved. We are working directly with Naval officials toward that end. Such an arrangement should accelerate the rate of realization of efficiencies in this very complex facet of the overall inventory control process.

2. What observations can you pass along about the quality of the contract administration over government furnished property? Are there enough personnel in that function? Are they adequately trained? Are they adequately compensated?

Response -- A recent Naval Audit Service audit concentrated on Government Furnished Material (GFM) which is a subset of Government Furnished Property (GFP). During that audit we observed that government property administrators were not exercising proper oversight of GFM held by contractors. We visited 21 contract administration offices and found material held by contractors exceeded need. We did not evaluate the adequacy of staffing nor did we review the qualifications of individuals conducting property administrator functions. Our findings did conclude that there is no correlation between approval of the contractor's property control system and the quantities of material excess to the individual contractor.

In support of our findings, a GAO draft report, Navy Internal Controls: Controls over Material Furnished to Contractors Can Be Improved, disclosed that government property administrators do not always provide adequate oversight of GFM received and held by contractors. GAO concluded that: property administrators were not performing required annual property surveys and, consequently, there could be no assurance that potential excess GFM was reported by contractors. GAO also concluded that a portion of the overall problem was due to a lack of sufficient property administration personnel.

The Department of the Navy had traditionally failed to apply adequate management attention to this facet of the contracting process. To assist in overcoming this deficiency, the Department, in 1985, established the Navy Governmental Property Council to ensure that proper policies were promulgated. Currently, this Council is chaired by the Director for Contracts and Business Management, Assistant Secretary of the Navy for Shipbuilding and Logistics (ASN(S&L)), and has representatives from all major Navy commands. Additionally, ASN(S&L) has appointed a staff professional to focus on government property policy oversight. More recently the Department has structured a management intern program to attract and train individuals with potential for becoming quality government property administrators. The initial participants will be selected this year.

In summary, our findings support your reservations about the quality of contract administration over government furnished property. We see evidence that the Department of the Navy is giving this area added emphasis. Given that emphasis, the quality and quantity of staffing should increase. I cannot state in exact terms whether or not changes in compensation or degree of training are warranted.

3. Do Navy contracts, which government furnished property will be provided, list by line-item and quantity all the property that is to be provided?

Response -- During our Government Furnished Material audits we found that aviation and repair contracts contained little specificity concerning what and how much material would be provided. Repair contracts did not list any of the items that would be provided. Production contracts only listed some of the information which generally involved selected control type items the government would provide. For these items, quantities were determined in accordance with guidance contained in the Master Government Furnished Equipment List.

The Navy is trying to rectify this. Officials advise us that for production contracts, where requirements can be reasonably predicted, most items of Government Furnished Property can be listed in the contract. They also advise, and our audits have confirmed, that on repair and overhaul contracts it is difficult to predict the specific part requirements that must continually be requisitioned from the supply system. The Navy is analyzing the advantages of using prior experience, engineered bills of material and statistical models to predict and document, with a high degree of confidence, the material requirements for repair and overhaul contracts. If a core material requirement for each repair/overhaul contract could be established, the Navy contract administrator would be dealing with unanticipated/-exogenous material needs on an exception basis thus improving the management of material provided to government contractors.

4. Will reporting of government furnished property on DOD's new DD 1662 form help the Navy in managing that property? Are there any problems with the form that need attention?

Response -- The DD Form 1662 will provide a "big picture" of the types and value of property provided to contractors. This data, as verified by the Navy's system of independent verification of contractor's records and contracts, form the basis of the Navy's financial accounting system for Government Furnished Property (GFP). Although Navy management is satisfied with the format of the DD Form 1662, it should be recognized that it will undoubtedly be "fine tuned" on a continuing basis as required.

Within the Naval Audit Service, we recognize that the value of the reports depends on their accuracy. During our GFP audits we found many instances of contractors misclassifying the various types of Government Furnished Property when preparing reports for the government causing the value of one type of property to be overstated at the expense another. We also noted many significant arithmetical errors in the preparation of the Form. These conditions diminished the value of the Form as a control and reporting mechanism. Recommendations for corrective action are being directed to appropriate levels of Navy management.

5. Please list the initiatives taken by the Navy to correct problems in providing government furnished property and give us your assessment of the adequacy of those actions.

Response -- Below is a listing of DON initiatives taken since 1983 designed to improving administration of the Government Furnished Property (GFP) oversight process.

May 1983 - NAVSUPINST 4440.169, limits supply system access by maintenance contractors.

Apr 1985 - Navy Government Property Council established.

Jul 1985 - SECNAV directed improved government property management.

Nov 1985 - Navy acquisition policy encourages contractor investment.

Mar 1986 - Navy submits DAR case requiring contractors to have equivalent systems for government and contractor property.

Mar 1986 - Navy requires equivalent systems for Navy contractors.

Mar 1986 - ASN(S&L) limits funds for repair of government facilities.

May 1986 - Joint ASN(S&L)/(FM) working group established to design system to financially account for government property in the custody of defense contractors.

May 1986 - ASN(S&L) limits property on service contracts.

Sep 1986 - ASN(S&L) directs review of GOCO's for potential sale.

Nov 1986 - Revised DD Form 1662 reporting implemented by Navy.

Dec 1986 - ASN(S&L) conducts procurement management review to determine level of property oversight at field activities.

Jan 1987 - Navy implements USD(A) property policy guidance.

Feb 1987 - ASN(S&L) restricts non-government use of Navy plant equipment.

Mar 1987 - Navy policy precludes "automatic roll over" of government property between contracts.

Apr 1987 - Navy policy clarified for government property, commercial activity program.

May 1987 - Begin Phase I of the Navy's Contractor Aviation Material Management System at the Aviation Supply Office.

Sep 1987 - Navy property intern program established.

Sep 1987 - Prototype financial accounting system for government property in the custody of defense contractors demonstrated at SUPSHIP Pascagoula.

Feb 1988 - Prototype financial accounting system demonstrated at NAVPRO Bethpage.

Feb 1988 - Last phase of the Navy's Commercial Asset Visibility Initiative started at the Ships Parts Control Center.

Mar 1988 - ASN(S&L) conducts Procurement Management Reviews of systems commands to determine compliance with Navy government property policy.

May 1988 - ASN(S&L) in coordination with CNO and NAVSUP undertakes project to remedy potential inefficiencies in providing material assets to contractors and in managing assets in their custody.

Jun 1988 - ASN(S&L) implementation of DODI 4140.48.

These actions have been primarily oriented toward supporting and complementing the policies and procedures promulgated by OSD. The Navy is now in the process of developing and implementing automated systems to implement the intent of the guidance. These actions are being augmented through the aggressive use of our management review and internal audit teams.

As mentioned in response to an earlier question, the Navy may soon establish within the office of the Chief of Naval Operations a focal point for receiving, reviewing, and directing remedies for potential inefficiencies in the Government Furnished Material (GFM) area. This focal point will assist in achieving significant efficiencies and serve as a firm basis in overcoming problems with GFM and adjacent areas concentrating on specific problems related to: the Navy visibility of GFM, degree to which GFM is provided, intent to oversee contractor management of GFM, and the Navy's intent toward establishing separate supply systems within the contractors' facilities.

The Naval Audit Service is working closely with the offices of the Assistant Secretary of the Navy for Shipbuilding and Logistics and the Chief of Naval Operations to ensure the above initiatives are successfully implemented. The actions cited are positive and should help in resolving the problems with GFM.

6. The Ships Parts Control Center's (SPCC) lack of accountability over repairable items at contractor facilities continues to trouble me. Although we were advised that the so-called CAV system will correct the lack of accountability problem by 1989, we have information which indicates it may take as long as 17 years to install the proper computers at each contractor facility to make the system operational. In effect, new repair contractors are coming on-board faster than the CAV system can accommodate them. I'd appreciate your comments on this situation.

Response -- The Naval Supply Systems Command approach toward improving accountability over repairable items at contractor facilities by developing the contract asset visibility (CAV) system was certainly a step in the right direction. The information you have concerning a 17-year implementation plan should be reviewed to ensure it is put in proper perspective. The recent initiative to upgrade the CAV system will strengthen the reliability and utility of information being reported by the contractors. It is planned that these enhancements will be operational on a system basis by the end of calendar year 1989.

Computer installation does not appear to be a factor that would delay the operational implementation of CAV. The CAV system requires only an IBM compatible microcomputer at each contractor facility, using software already developed by the Navy.

New repair contractors coming on-board should not adversely affect the CAV system since the CAV system is currently designed to accommodate only the top 140 repair contractors, covering about 85 percent of the value of repairable items. Other control systems are currently used or are planned to provide accountability over repairable items at contractor facilities not included in the CAV system. We currently plan to audit the effectiveness of SPCC systems in providing visibility, control, and accountability of material undergoing repair at contractors' facilities early in Fiscal Year 1990. This audit will include CAV and any other systems used to provide accountability over repairable items at contractor facilities.

United States General Accounting Office

GAO

Testimony

DOD'S MANAGEMENT OF GOVERNMENT PROPERTY FURNISHED TO DEFENSE CONTRACTORS

Statement of Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division

Before the Committee on
Governmental Affairs
United States Senate

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our work on the long-standing problems that the Department of Defense (DOD) and the military services have had in controlling and accounting for property they furnish to defense contractors. These contractors use the property to develop, produce, and maintain Defense weapon systems and support military installations worldwide.

RESULTS IN BRIEF

DOD furnishes billions of dollars of property to defense contractors each year. However, the exact amount of government property currently in the hands of contractors is unknown. Until August 1986, there was no system in place for periodically reporting the value of government property in the hands of contractors. The data collected by DOD since then shows that as of September 30, 1986, the total was over $26 billion.[1] However, we believe that the total amount of property on hand may be even larger than the 1986 figure, because contractors' records do not, in many cases, adequately account for this property, and DOD and the services currently have no overall management or financial systems in place that could independently verify contractor records. Also, some contractors did not submit the necessary data for inclusion in the total figure.

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[1] Contractors had an additional $19 billion of other government property, such as real estate and special tooling, in their possession.

Several factors contribute to the problems in controlling and accounting for property furnished to contractors. First, DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to furnish it. Second, the services have not yet implemented or have inadequately implemented DOD instructions designed to control contractor access to the DOD supply system. Third, DOD has not adequately enforced the provisions of the Federal Acquisition Regulations (FAR), which require that contractors account for and safeguard government property in their possession. Fourth, DOD and the services have not yet implemented financial accounting systems that would give them independent data for judging whether contractors' records are accurate. In our opinion, these factors need to be adequately addressed to ensure that the potential for fraud, waste, and abuse is minimized, maximum benefits accrue to the government, and the government's sizeable investment in property is safeguarded and protected.

DOD has taken a series of steps to correct some of the deficiencies that we have reported on over the last 20 years. However, overall corrective actions have been slow and focused primarily on modifying existing policies rather than implementation and enforcement.

Our testimony, which will also identify and discuss DOD and service actions to alleviate known problems, will focus on one category of government property--government material--furnished for the performance of maintenance and service contracts. We will also briefly discuss our past efforts on DOD's management of government-furnished equipment (GFE), which for purposes of this testimony, we define as industrial plant equipment, other plant equipment, and special test equipment.

BACKGROUND

GFE includes industrial plant equipment, other plant equipment, and special test equipment used or capable of being used in the manufacture of products or performance of services. Government-furnished material includes parts, components, assemblies, raw and processed materials, and supplies that (1) may be incorporated or attached onto final products, such as aircraft, tanks, and ships or (2) may be expended or consumed in performing a contract, such as office supplies.

DOD's 1986 report on property showed the following amounts of government material and GFE as of September 30, 1986.

Table 1.1: Reported Amount of Government Material and Equipment Furnished to Defense Contractors

Defense component	Government material	Government equipment	Total
	(billions)		
Army	$ 2.4	$ 3.4	$ 5.8
Navy	7.7	2.7	10.4
Air Force	6.0	4.1	10.1
Other	-	0.1	0.1
Total	$16.1	$10.3	$26.4

Government material consists of those items provided from the DOD supply system as government-furnished material (GFM), and items purchased by the contractor with government funds from commercial sources, commonly referred to as contractor-acquired material (CAM). Our review work focused on GFM, except in those instances when the GFM and CAM could not be readily segregated in the contractors' records.

The FAR sets forth the government's policy on providing material to contractors. The regulations state that contractors shall ordinarily furnish all material for performing government contracts. However, material may be provided to a contractor when it is determined to be in the best interest of the government by reason of economy, standardization, the expediting of production, or other appropriate circumstances.

When GFM is authorized, it is provided to defense contractors in two ways--"push" or "pull." Under the push method, the government computes a contractor's material requirements and has the material shipped directly from either its supply system or a third party, i.e., another contractor. The contractor does not submit requisitions to the government for any of the material. Under the pull method, a contractor determines his own material requirements and, upon government review and approval of the requirements, obtains the material either directly or indirectly from the DOD supply system.

To enable certain contractors to requisition, receive, and be billed for GFM, the services assign them six-digit codes, called DOD Activity Address Codes (DODAACs). These contractors are authorized to use their DODAACs and follow standard DOD requisitioning procedures to obtain materials directly from wholesale level supply inventories.[2] Other contractors obtain material directly by ordering from on-base supply activities, which replenish their stocks from the wholesale inventories, or by having a service's organization order the material directly from the wholesale level which then turns the material over to the contractor for his use.

The FAR and contract provisions prescribe that contractors are responsible for establishing and maintaining systems to control, protect, preserve, and maintain all government property, including GFM. These systems are subject to review and approval by DOD property administrators. To do this, property administrators are to perform annual surveys of the systems. The surveys are divided into 10 categories ranging from property acquisition, use, and consumption to receiving and recordkeeping. Deficiencies noted during these surveys are to be reported to the contractor for prompt corrective action. If the contractor fails to establish and maintain an effective property control system, the government can disapprove the system, and the contractor can be held liable for future losses or damage to government property.

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[2] For purposes of this testimony, wholesale inventories refer to materials stored by inventory control points for distribution to retail or base level activities. It includes materials managed by all military services, DLA, and the General Services Administration.

Further, the government's policy is to rely almost entirely on the contractor's property control records. The FAR designates the contractor's books as the official records. According to the FAR, these official records must identify all government property and provide a complete, current, and auditable record of all transactions. Generally, defense agencies do not maintain independent records of property after it has been provided to contractors.

GOVERNMENT-FURNISHED MATERIAL: NEED FOR BETTER MANAGEMENT CONTROLS, OVERSIGHT, AND ACCOUNTABILITY

Since 1967, GAO and Defense internal audit organizations have issued numerous reports on the management, use, and accountability of GFM (see attachment I). These reports contain many examples of deficiencies and abuses of established government and DOD policies and procedures. Major systemic deficiencies include: (1) the basic government policy of relying on contractors to provide material needed for government contracts has not been effectively implemented; (2) government oversight of defense contractor property control systems has been inadequate; (3) contractor handling of GFM is in need of improvement; and (4) DOD has not had financial accountability over GFM.

Our review of the reports, coupled with the results of our recently completed work at selected service commands, installations, and contractors, showed a continuation of the previously reported systemic deficiencies. A summary of our major findings follows.

Lack of compliance with government policy on providing material

When it is in the best interest of the government, DOD can provide material to contractors. It might be appropriate, for example, for the government to provide an item that is military-unique or not readily available from commercial sources.

DOD policy contained in DOD Instruction 4140.48 (Control of Access to DOD Material Inventories Required By Defense Contracts), DOD Instruction 4100.33 (Commercial Activities Program Procedures), and various service directives state that decisions to provide material should be supported by sound rationale and be documented in writing. However, commands and activities we visited were generally not complying with the policy for reasons ranging from being unaware of existing DOD and service policies in this area to following past practices, which presumed that it was inherently less costly and troublesome for the government to provide materials to contractors than for contractors to buy it commercially. For example:

-- We reviewed 19 maintenance contracts at 3 Air Force Air Logistics Centers, but only 1 of them contained a written justification for GFM. Officials at one Air Logistics Center stated that none of its 201 maintenance contracts contained the required justifications.

   Some personnel were not aware of the policy on GFM, and others followed an outdated (1978) regulation, which stated that the government would normally provide, as GFM, parts available in the DOD supply system. This regulation was revised in 1984.

-- We reviewed 8 randomly selected maintenance contracts at the Navy's Aviation Supply Office, but none contained written documentation to support the decision to provide GFM, as required by Navy policy. The Supply Office inventory managers said that in recent years they had followed the practice of providing contractors with all material necessary for contract performance.

-- Although DOD had a policy since at least 1985 requiring contractors to provide all material necessary to accomplish their service contracts, we found that, with few exceptions, service contracts at Army, Navy, and Air Force installations authorized that all material needed by contractors would be provided as GFM. This happened, even though some of the material was readily available from commercial sources and could be obtained at lower cost. Material provided as GFM included such items as paint, lumber, common hardware, car wax, office and automotive supplies, and videotapes.

On the cost issue, we found instances where contractors could obtain material from commercial sources at substantially lower cost than from the DOD supply system. For example:

-- One Air Force contractor was authorized to buy 18 air compressor doors commercially because they were not in stock in the DOD supply system. He obtained the doors for $21 each commercially, whereas the DOD catalog price was $253.

-- Another Air Force contractor obtained numerous electronic components commercially at a price less than half of the DOD catalog price. He was required by his contract to identify the most economical source and then either buy the parts commercially and be reimbursed or requisition them from the DOD supply system. During fiscal year 1986, the contractor obtained about 90 percent of his $16.4 million of material from commercial sources.

DOD concurred with our findings and stated that its policy regarding the need for justification prior to providing GFM to contractors is clear. DOD stated that the problem was essentially one of compliance and that steps would be taken to ensure better compliance through monitoring and testing by Air Force headquarters and its Inspector General.

Inadequate controls over the issuance of GFM to contractors

In response to the reports of numerous abuses of DOD policies shown in attachment I and various congressional reports resulting from hearings on this subject (see attachment II), DOD issued an instruction (DODI 4140.48) in March 1981. This instruction required the services to establish one or more management control activities (MCA) to maintain central control over maintenance contractors' access to the DOD supply system by reviewing, validating, and approving contractor requests for GFM. DOD expected implementation of this instruction by November 1982. In March 1986 DOD issued a revised instruction that expanded the scope to all types of contracts, including both base and centrally awarded service, production, and research and development contracts. However, the instructions have either lacked full implementation by the services or implementation procedures and practices have been ineffective. For example, with respect to maintenance contractors:

-- The Army has not yet implemented MCA controls as envisioned by DOD because it has not completed development of an automated system it believes is needed to effectively implement such controls. According to Army officials, contributing factors that slowed MCA implementation were limited coordination between Army organizations involved in supply and contracting and a lack of resources thought necessary to establish and maintain MCAs. DOD projects full Army MCA implementation by June 1989.

- -- The Navy has not yet established an MCA at its Ships Parts Control Center or fully implemented a MCA at the Aviation Supply Office. At the Supply Office, the MCA controlled only 37 of 117 maintenance contracts. The remainder was not controlled. The Supply Office has started to develop a new, automated MCA system, which it expects to be fully operational by December 1989.

The Air Force has established MCAs to control GFM for its maintenance contracts. However, current Air Force procedures and practices for reviewing, validating, and approving GFM requisitions do not ensure that contractors requisition and receive only needed items and amounts of GFM. This has occurred for a number of reasons.

- -- The Air Force has not properly implemented a regulation that requires the identification of specific parts and quantities needed by contractors to execute maintenance contracts. As a result, contractors have had access to and have ordered unneeded material. For example, in its 1986 report on the effectiveness of internal controls on GFM, the Air Force Audit Agency tested 180 out of a total of

1,037 contractor requisitions during a 2-month period (November and December 1984). Of the 180 requisitions, 33 were for unauthorized/unneeded items valued at $334,000. The Air Force concurred and stated that new procedural guidance would be issued by January 1986. However, our review showed that the potential for obtaining unneeded/unauthorized items still exists.

-- The MCA system currently has no checks to prevent a contractor from exceeding maximum part quantities needed to perform a contract, and contractors can avoid edits designed to prevent them from depleting inventory stock levels. For example, one contractor had submitted 45 requisitions, each for 19 electrical parts, for a total of 855 on the same day. The contract limited the contractor to 90 parts. The contractor avoided the maximum quantity of 20 items per requisition for this part by ordering one less part on each request. The multiple contractor requisitions depleted the entire DOD inventory of these parts.

-- Some Air Force contractors have obtained GFM without prior MCA review and approval by accessing the supply source directly. For example, the Air Force Audit Agency reported in 1986, that 161 out of a total of over 81,000 material requisitions were filled in this manner. The material obtained was valued at $137,000. Of the 161 requisitions, 107 requisitions that were submitted by one contractor, valued at about $95,000, were determined by the Air Force Audit Agency to be improper and were referred to the Air Force Office of Special Investigations for further assessment.

-- GFM authorizations were modified by Air Logistics Center staff without the necessary approval from the contracting officer as required by the FAR. We identified two contracts at one Air Logistics Center that were improperly modified. As a result, two contractors received about $722,000 of GFM that they were not authorized to obtain by their contracts. Center officials agreed that the contracting official should have been notified and stated that the current practices would be discontinued immediately.

We found that all of the services have taken or are taking some action to implement the revised instruction on nonmaintenance contracts awarded either centrally or at the base (retail) level. However, none of them has developed a definite plan of action or a target date for full implementation.

Weaknesses in controls over material after issuance to contractors

As previously mentioned, the FAR and contract provisions specify government and contractor responsibilities for establishing and maintaining control over material provided to contractors.

Our work and recent Defense audits disclosed weaknesses in both contractor controls and government oversight over GFM. These conditions have contributed, in some cases, to the accumulation of excess material.

The following are examples of contractor property control weaknesses and ineffective government oversight of GFM.

-- One Navy contractor had accumulated potential excess material valued at $7.1 million under one contract. The government's property surveys for 1982 through 1986 disclosed that the contractor (1) had no written procedures for conducting physical inventories, (2) had not taken annual GFM inventories, (3) was not adequately monitoring GFM under the control of subcontractors, (4) did not report all instances of GFM losses and damage, (5) had lost material when transferring between locations, and (6) had recorded property balances that differed significantly from the property administrator's physical inventory. In

December 1986 the contracting officer threatened the contractor with disapproval of his property control system.

Navy and contractor officials agreed that there was potential excess GFM. They are now determining the exact amount of excess material and what to do with it. Contractor officials also agreed that the property control system problems were long-standing and said that they would take corrective action.

-- Another Navy contractor, who had accumulated $2.4 million of potential excess GFM under one contract, did not record more than $670,000 of GFM on its property records. The government was not aware of this omission, since there was no government property administrator assigned during fiscal year 1986. The property administrator told us that during fiscal year 1987, he was not given the authority by the contracting officer to review the contract and the contracting officer did not have the staff to do it.

Contractor personnel agreed that they should have accounted for the material until it was actually used and said they would begin accounting for GFM in this fashion.

-- A May 1985 Naval Audit Service report stated that a contractor with over $303 million of government-furnished property, including $36 million of GFM, operated with outdated and incomplete property control procedures. Some of the procedures, which had been approved in the early 1970s, had not been updated. The report concluded that, as a result, there was no assurance that the property was adequately controlled.

-- The Naval Audit Service in an August 1986 report stated that, although the property administrator's annual surveys showed that a contractor adequately controlled his $526 million of GFM, substantial quantities of excess material ($146 million) may have accumulated. This condition existed because inventory tests performed by the property administrator were done only to verify that material issued from government stocks was authorized. Such tests would not detect excess material on a program-wide basis. The Navy concurred with the report and has (1) transferred $30 million of the excess inventory to other users, (2) disposed of $5 million because it was obsolete, and (3) agreed to review the remaining excesses.

-- At an Air Force contractor, the government property administrator was not aware that between November 1985 and October 1986 the contractor had requisitioned about $102,000 of GFM, from 27 federal stock classes, which was not authorized in the contract. At the same contractor plant, the property administrator also did not routinely review GFM stock on hand to identify excess inventory, as required in the contract, because the contractor's GFM inventory status report to the responsible Air Logistics Center lacked sufficiently detailed information on such things as item descriptions, part replacement rates, and item costs. Over $360,000 of GFM was on hand in early 1987, and a contractor official believed that most of it was excess to existing needs.

-- At one Air Force Base, neither the contracting officer nor the acting property administrator knew that one contractor did not maintain records for GFM items valued at $50 or less and had not determined that this GFM was necessary to perform the contract. Subsequent to our field work, the contractor performed a physical inventory of all GFM in its possession and determined that the value of the inventory was $4.4 million. About $2.5 million (57 percent) was for items with a unit price of $50 or less. Much of the $4.4 million inventory may be in excess of needs. For example, from our random sample, 42 percent of 132 selected GFM items valued in excess of $50 had not been used in 1-1/2 years and 33 percent had not been used in at least 3 years.

-- The Air Force Air Logistics Centers provide contract administrators with quarterly listings of GFM shipped to contractors to allow property administrators to independently verify the accuracy of contractor GFM receipt records. However, the listings were often not used, especially when property administrators were not permanently stationed at the contractor's plant. For example, property administrators in the Orlando Defense Contract Administration Services Management Area, which has surveillance responsibility for about 150 contractors throughout Florida, did not use the lists in their property surveys because they claimed they did not have sufficient time to do so. We found only one property administrator who used the GFM shipment lists.

The Air Force Audit Agency made similar observations in its 1987 report on GFM controls at contractor facilities. The Agency reported that from six Air Force Plant Representative Offices reviewed, none of the property administrators used the shipment lists. Instead they used contractor receiving documents to reconcile contractor GFM balances. The Agency attributed this to Air Force Contract Management Division directives that did not incorporate the March 1981 and 1986 DODI 4140.48 procedures for independent verification.

During our review we found several instances indicating that the property administration area, especially at military installations, suffered from personnel shortages. For example, the Naval Regional Contract Center, Long Beach, California, which awards all types of contracts for the western part of the United States, had no property administrator and needed to rely on military installations to provide property administration services. Of the 120 military installations the Center served, only one had a property administrator.

DOD has recognized that over the years the property administration function has been given a relatively low priority for personnel resources. In 1986 DOD directed the services to realign existing resources to provide for adequate staffing.

Accountability and financial controls

Since 1967, we--as well as congressional committees--have criticized DOD and the services for not having established property accountability and financial accounting controls over GFM. We recommended in two reports that DOD and the services establish accounting systems that adequately account for (1) the quantity and value of government material authorized and provided to contractors and (2) the receipt and use of this material by contractors.

In October 1983 DOD published its accounting manual, DOD 7220.9-M. This established financial property accounting principles to be implemented by the services in their accounting systems. The manual also includes general ledger control accounts for material and equipment. The services are currently developing accounting systems, which they plan to implement by late 1989. When the accounting systems are developed, they would provide government property administrators with independent data that could be used to judge the accuracy of DOD's new property accountability system discussed below.

In the property accountability area, DOD established a database system in August 1986 called the "Department of Defense Industrial Property Management System." This system is to provide managers with sufficient visibility to adequately manage government-owned assets that are under their responsibility. Specifically, using contractor records, the system tracks the beginning and ending fiscal year on-hand balances of all DOD property on a contract-by-contract basis. The balances are expressed in terms of quantity, except for material and real estate, and dollar value. DOD has completed its data collection effort for fiscal year 1986 and reported its result. It is now working on fiscal year 1987 data.

While the actions taken by DOD in the property accountability area are steps in the right direction, we have concerns with the accuracy and completeness of the data reported. Our review of the 1986 DOD property report disclosed that it was incomplete, because not all contractors with property had submitted the required data. For example, three Navy contractors we reviewed, who had about

$21.2 million of GFM under three contracts, had not reported the necessary data. Another Navy contractor who had reported did not include two contracts with material valued at about $22.5 million in his data submission. The same contractor also did not include GFM values for over 56,500 line items out of a total of over 65,700 line items on 4 other contracts. The value of the remaining 9,200 line items was about $59.6 million. In addition, a 1987 Naval Audit Service report disclosed that a contractor had overstated the GFM value on his records by $1.5 billion. The report also pointed out that the Audit Service could not account for an additional $900 million of government property recorded in the contractor's property system.

We are also concerned that the DOD property report does not contain data dealing with the amount of government material added (acquired) and deleted (used, returned, or disposed of) during each fiscal year. The amount of material added and deleted is in the billions. For example, one Army contractor had obtained an estimated $236 million of government property during fiscal year 1986. On a broader scale, the Air Force Audit Agency reported in 1987 that the Air Force provided an estimated $11.5 billion of GFM during fiscal year 1985 to contractors.

Information on the value of additions and deletions is desirable for several reasons. One reason is to let managers at various levels know the amounts of material that have been provided, used, or disposed of under each contract, for each command, or for each service. Second, the information can be used to identify contracts with potential excess material by relating on-hand balances to additions or deletions. Third, it would provide information on material provided on contracts where work has been completed.

DOD officials informed us that they decided not to include the additions and deletions because they believed the collection of such data would not be cost-effective.

GOVERNMENT FURNISHED EQUIPMENT: MANAGEMENT AND CONTROL PROBLEMS CONTINUE BUT IMPROVEMENT ACTIONS ARE UNDERWAY

The management and control of GFE was identified as a problem more than 2 decades ago, and numerous reports have been issued by DOD audit agencies and us since then on this subject. These reports basically have identified recurring problems in the management, control, and use of GFE.

Our most recent work in the GFE area resulted in a June 1986 report to the Secretary of Defense entitled Government Equipment: Defense Should Further Reduce the Amount it Furnishes to Contractors. This report advised the Secretary that management oversight problems reported on in the past had remained essentially unchanged and that little progress had been made by DOD in implementing overall government policies that call for minimizing the amount of equipment the government furnishes to contractors. More specifically, the report pointed out that several major factors had impeded progress, including

- -- vague FAR and Defense FAR Supplement provisions, which had allowed government officials to permit contractors to acquire new, general purpose equipment such as office equipment and vehicles;
- -- limited Defense efforts to motivate contractors to provide their own equipment;
- -- inadequate equipment acquisition guidelines, especially for service contractors; and
- -- continuing management oversight problems at field and headquarters levels over the acquisition, use, retention, and disposal of GFE.

Other factors that have hindered efforts to reduce GFE include (1) legal uncertainties surrounding disposal of equipment at contractor-owned, contractor-operated plants and (2) limited efforts by the Army and Navy to determine the prospects for selling government-owned, contractor-operated plants.

The report recommended that the Secretary of Defense develop an overall strategy for reducing GFE. As part of this strategy, we recommended, among other things, that the Secretary direct

-- the Defense Acquisition Regulatory Council to take steps to amend the DOD FAR Supplement to allow the military services and defense agencies to provide general purpose equipment to contractors only under highly unusual circumstances, which are clearly defined, adequately controlled, and properly justified;

-- his office and the Army, Navy, and Air Force to develop specific guidelines for program managers and local contracting officials to use in determining when and under what conditions the government can provide general purpose equipment to service contractors;

-- the three services to (1) identify general purpose plant equipment acquired by contractors under other than facilities contracts and (2) determine and recoup any improper profits or fees that were added as a result of such acquisitions;[3]

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[3] Facilities contracts allow the government to reimburse the contractor for only the actual cost of the equipment, with no add-ons for profit or fees.

-- the Army and the Navy to undertake comprehensive reviews of their government-owned, contractor-operated plants to determine which ones could be sold, and then to consummate such sale;

-- his office to establish an adequately staffed central office for government-furnished property, including GFE. This central office should have, at a minimum, information on the quantity and value of GFE acquired annually by each service, how it is being used, and how much is being discarded. In support of this office, each service secretary should designate a focal point responsible for the overall management of government-furnished property within the service.

DOD AND SERVICE INITIATIVES

In response to DOD and our past report recommendations on government property, the Undersecretary of Defense for Acquisition issued a property policy memorandum in November 1986. This document provides guidance to the services for improving the management of all government property in the possession of contractors. For example, the services were directed to (1) reduce the amount of government property provided to contractors, (2) improve property accountability records, (3) establish standard financial accounting systems, and (4) determine and recover any improper profit or fees paid to contractors for acquiring equipment under facilities contracts. DOD expected aggressive implementation of this policy to take place in order to show positive results.

In addition to advising Congress of this "new" policy in January 1987, DOD officials briefed your Committee staff on February 18, 1988, on the policy and provided some data on actions taken. The DOD Inspector General and the Defense Council on Integrity and Management Improvement are tracking progress. We believe that the initiatives address the major property issues raised over the years and, **if properly implemented**, should have a positive impact on the government's ability to minimize the potential for fraud, waste, and abuse of government property.

The services have also initiated a number of actions to improve their management and control of government property. For example, the Army has made a number of changes to existing DODAAC procedures, such as limiting the shipment of GFM to only authorized addresses to reduce opportunities for fraud, waste, and abuse. The Navy has prepared a draft instruction that will standardize existing GFM requisition review and approval procedures for all contracts. The Air Force programmed their automated supply systems to edit contractor requisitions for material by stock number rather than by stock class, thereby improving internal controls over the GFM requisitioning process.

Most of the service actions appear to be oriented toward refining existing policies and procedures. While this may be necessary, the focus needs to be on implementation and enforcement rather than modification of these policies and procedures.

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In summary, DOD and the services have had long-standing problems with the management, control, and accountability for property--material and equipment--they have furnished to contractors. These problems continue.

-- DOD has not effectively implemented the basic government policy of relying on contractors to provide all the property needed for government contracts, except when it can be demonstrated that it is in the government's best interest to do so.

-- The DOD and service regulations designed to control contractor material requisitions submitted to the DOD supply system have either not been implemented or were inadequately implemented.

-- The provisions of the FAR that require contractors to account for and safeguard government property in their possession and the government to maintain oversight over the contractors' management of the property have not been adequately enforced.

-- DOD and the services have made slow progress in developing and implementing financial property accounting systems, which would give the government independent data for judging the accuracy of the contractors' records.

As a result, there is no assurance that the government's sizeable investment in property has been adequately protected; the potential for waste, fraud, and abuse is minimized; and maximum benefits accrue to the government.

To ensure that these actions are actually implemented, we recommend that the Secretary of Defense establish firm milestones for implementing each of the actions and direct his Inspector General to independently monitor and report on the progress made by the DOD components.

SUMMARIES OF GAO AND DEFENSE REPORTS ON GOVERNMENT-FURNISHED MATERIAL

U.S. GENERAL ACCOUNTING OFFICE REPORTS

Need for Improvements in Controls Over Government-Owned Property In Contractors' Plants (B-140389, Nov. 1967)

We reported on the need for DOD to improve its system of controls over government-owned facilities and material in the possession of contractors. The accounting systems employed by contractors did not provide for financial control, and acceptable physical inventories of government-owned material were not conducted. Weaknesses were attributed to vague ASPR instructions, deficient physical inventory taking, and departure from good property management procedures.

We recommended to the Secretary of Defense that ASPR be amended to require financial accounting controls for government-owned material in the possession of contractors.

Better Management of Government-Furnished Material Could Decrease Cost of Base Maintenance Contracts (PSAD-76-79, Feb. 1976)

Material management procedures at the Los Angeles Air Force Station did not provide control over Air Force material and would not preclude misappropriation from occurring. The lack of control occurred despite a general compliance with Air Force regulations; therefore, this situation could exist at other Air Force locations.

Second GAO Report on Need for Better Control Over Government Furnished Material Provided to Defense Overhaul and Repair Contractors (PSAD-76-78, Mar. 1976)

In a June 1970 report we advised the Secretary of Defense that inadequate administration of government property by contractors and the services had resulted in (1) unnecessary investment in inventory, (2) increased transportation costs, (3) possible unnecessary procurement, and (4) potential shortages at some locations. One of the underlying causes of the deficiencies was inadequate surveillance of contractors' performance by responsible property administrators. Generally, the services agreed with the findings and said corrective actions were being taken.

However, a February 1974 internal DOD audit report said little, if any, management attention was being paid to the control of GFM in contractor plants.

Our follow-up work found weaknesses in the accountability procedures for GFM. For example:

-- Air Force contractors ordered government materials directly from government supply systems and received direct shipments with little or no Air Force surveillance.

-- There was no established way to find out from government sources the amounts of materials ordered and received from contractors.

-- Contractors' consumption of government material could not be compared against expected or planned use rates because the material requirements lists provided by the Air Force to contractors were incomplete.

When the records of materials given to contractors were kept by contractors, which also had physical custody of these materials, we believed minimum acceptable control would require a way for government representatives to verify contractor reports of materials received, used, and remaining in inventory. Independent verification and evaluation would require the following:

1. A Government record by national stock number, quantity, and dollar value of the government material given to individual contractors. This could be done by furnishing government property administrators with information on government material shipped to contractors.

2. Periodic verification of the accuracy of contractors' records by comparing them with the government's records of material shipped to the contractors and auditing contractors' usage reports. In addition, the practice of taking physical inventories of materials on hand should be continued.

3. Preparation of better estimates of expected usage of government-furnished material. This includes periodic evaluation of the reasonableness of such estimates and appropriate adjustments when necessary.

DOD advised us that a joint Air Force/Defense Contract Administration Service task force was studying the problems of controlling government-furnished material, and therefore it felt additional directions to those agencies were unnecessary.

Increased Use of Available Aviation Assets in New Production Can Save Millions (LCD-79-201, Mar. 1979)

The Navy needed to improve its procedures and practices for (1) identifying quantities of items in long supply that could have been used in new production of aviation equipment, (2) advising contractors of the availability of long supply items, and (3) having items furnished to contractors with equitable reductions in the appropriate contract prices. Substantial savings were available in inventory holding and procurement costs through timely utilization of long supply assets.

Our review of the Navy's performance showed:

- lack of management emphasis and interest on the part of personnel responsible for administering the program,
- ineffective implementation of and noncompliance with existing policies,
- weaknesses in existing procedures and practices, and
- lack of visibility and feedback systems at top management levels of the Navy and DOD for monitoring and measuring the success of the Navy's program for making maximum use of available aviation system assets in new production.

The Army Should Increase Its Efforts to Provide Government-Furnished Material to Contractors (LCD-80-94, Aug. 1980)

By not screening long supply inventories for possible use as GFM on production contracts, four Army inventory control points may have been losing the opportunity to achieve significant savings or may have lost future opportunities. Such screening, which is required by Defense and Army policy, was performed by one Army control point with beneficial results. However, Army commands did not adequately exercise their oversight responsibility to ensure compliance with this policy.

Weaknesses in Accounting for Government-Furnished Materials at Defense Contractors' Plants Lead to Excesses (FGMSD-80-67, Aug. 1980)

DOD did not maintain adequate accounting for GFM provided to production contractors. As a result, millions of dollars of GFM were provided to contractors (1) in excess of their contract authorizations and (2) in excess of their amount required to fulfill the contract. Several of the weaknesses found in prior audits on control of GFM furnished to contractors for use in overhaul, maintenance, and repair contracts also existed in production contracts.

To insure that there was adequate accounting for GFM provided to production contractors, we recommended that the Secretary of Defense should discontinue DOD's policy of almost total reliance on contractor property control records and establish systems that, together with records maintained by the contractor would provide accounting control over Defense material from receipt to consumption or disposal.

The Navy was Not Adequately Protecting the Government's Investment In Materials Furnished to Contractors for Ship Construction and Repair (PLRD-81-36, June 1981)

The Navy needed to make improvements in its management of GFM to ensure the government's investment was adequately protected.

The Navy had no central point of control or accountability for GFM. Instead, many commands were involved in its management, and their efforts were not coordinated to prevent duplication or to ensure consistency. These problems were compounded by the lack of inventory manager visibility over GFM in the possession of the Navy's Supervisors of Shipbuilding, Conversion and Repair (SUPSHIP) and contractors. Moreover, no activity regularly monitored the performance of the various SUPSHIPs to ensure consistent interpretation and application of GFM regulations and directives.

Although the SUPSHIPs' basic regulations and directives for GFM management were the same, GFM managers did not interpret and apply these in the same manner. As a result, their effectiveness in managing GFM varied widely.

The Seattle SUPSHIP was managing GFM in a more effective manner by enforcing Defense Acquisition Regulation (DAR) requirements on contractors and by using an in-house computerized monitoring system for management prior to delivery to the contractor.

The failure of three other SUPSHIPs to fully enforce DAR led to inaccuracies and inefficiencies in contractors' GFM control systems, caused excess items to be held for extended periods of time, and inadequately protected the government's interest.

Other areas need improvement:

-- Unnecessary costs may have been incurred when SUPSHIPs did not screen excess new GFM against future needs.

-- NAVSEA activities involved in GFM procurement lost sight of items located in both the contractors' and SUPSHIPs' warehouses. This created the potential for unneeded procurement.

DEPARTMENT OF DEFENSE REPORTS

Defense Supply Agency

Audit of Government-owned Material at Selected Overhaul and Maintenance Contractors (Oct. 1976)

Surveillance of contractors' property control systems was inadequate. Tests of GFM at 66 contractors disclosed about $9.2 million of material was used on commercial work, sold to the government as contractor-furnished material, or acquired without contractual authority or in excess of needs.

Defense Audit Service

Administration of Maintenance, Overhaul, and Repair Contracts (May 1978)

Longstanding deficiencies still continue in the acquisition and use of GFM by contractors and the surveillance of the requirements and use of material by DOD property administrators. We recommended that DOD should limit the access of repair contractors to the DOD supply system and require contractors to finance inventories of material.

President's Council on Integrity and Efficiency

Department of Defense Inspector General Summary Report on Audit of Government Property in the Possession of Contractors/Grantees (Aug. 1983)

This interagency audit report summarized the internal control problems identified in over 30 agency audit reports on government property provided to contractors and grantees. Internal controls over the acquisition and accountability for government property in the possession of contractors were weak. These weaknesses resulted in unnecessary program costs and the loss of government property.

Contractors acquired and retained more property than they needed for the contracts because of inadequate acquisition guidelines and government oversight. Contractors had few incentives to finance needed property or to exercise prudence in acquiring property with government funds. Weak government and contractor controls resulted in unneeded purchases. The government did not maintain independent financial controls and relied on contractor controls, even though many of the contractors had inadequate property control systems.

With no incentives to maintain effective internal controls for property, contractors had little financial liability for lost or damaged property. As a result, the government did not know how much of its equipment contractors had; contractors did not properly safeguard government property; and program costs increased because of property losses and unneeded property bought by contractors.

DOD Inspector General

Government-Furnished Material at DOD Production Contractors, DOD-IG Audit Report (84-032, Feb. 1984)

The DOD-IG, the Army Audit Agency, the Naval Audit Service, and the Air Force Audit Agency audited the use of GFM by production contractors. The audits showed that the special reports on GFM, requested by the Office of the Secretary of Defense from the military departments, were inaccurate and incomplete. In most cases, the contractors and cognizant property administrators had not been contacted to respond to the OSD request for data on GFM.

Excess material worth $24.8 million was found at 15 production contractor plants. This excess resulted from DOD activities shipping more material than required to production contractors and from contractors ordering more than required. Some of the excess material could have been used to satisfy operational requirements of the services.

Air Force Audit Agency

Management of Depot-Level Contract Maintenance (June 1978)

There was a lack of visibility and control to preclude repair contractors from requisitioning unneeded GFM from the DOD supply system. Comparison of contractor actions on the same item showed that out of $1.8 million of GFM requisitioned, $1.3 million was returned to the Air Force. The Air Force industrial fund had to absorb losses for noncredit returns of about $247,800 because at the time of return, this material was excess to Air Force needs.

Computer Controls Over Material Furnished to Repair Contractors (July 1978)

Test transactions showed that contractors could bypass the existing controls over GFM requisitions without being detected and requisition material from the DOD supply system. In a 5-month period the system processed billings for 720 shipments valued at $444,000, which was not recorded in the Air Force system. These disparities were caused by the contractors sending requisitions directly to the source of supply rather than the funding Air Logistics Center.

Air Force Managed Sensitive and Pilferable Items (Mar. 1981)

Contractors could request and receive unauthorized GFM. Five intentionally miscoded requisitions were entered into the Air Force DO32 system. Four of the requisitions were processed, and supply distribution personnel moved material to the shipping area before they were stopped. Invalid requisitions were processed because procedures did not require material management personnel to match GFM shipments with requests made by other Air Logistics Centers.

Review of Government Property in the Possession of Contractors, Air Force Plant Representative Office, Rockwell International, North American Aircraft Operations, El Segundo, Calif. (945-12, Feb. 1983)

The Rockwell International, El Segundo plant had deficiencies in the way property was acquired and accounted for. Problems existed in the areas of property inventories, record accuracy, acquisition methods, and classification of equipment. The property administrator at the plant had reportedly made no property survey since 1978.

Review of Government Property, Air Force Plant Representative Office, Lockheed-Georgia Company, Marietta, Ga. (975-7, Mar. 1983)

Government controls were adequate to ensure that contractor procedures and practices for acquiring government property followed contractual provisions. The property administrator's property surveys were accurate, reliable, and timely. However, government materials on hand were excess to contractual requirements, but the property administrator had taken no action. Property accountability records, showing location and identity data, were not always accurate. Also government equipment was used without proper approval or authority.

Internal Controls Within Systems for Managing Material Furnished to Maintenance Contractors (5126113, Jan. 1986)

Air Force maintenance contractors bypassed existing management control activities controls, then requisitioned and received unauthorized and unneeded materials and the contractors failed to cancel outstanding GFM orders (back orders) after contracts were completed. Also, an expensive Air Force computerized system to monitor and control GFM held by maintenance contractors was ineffective.

Government Furnished Material at Contractor Facilities (6076410, Feb. 10, 1987)

We identified several areas where GFM controls could be improved at several Air Force Commands, Air Logistics Centers, and at six contractor locations. Specifically, the GFM transaction reporting system did not provide accurate and timely information; controls limiting contractor access to DOD material inventories for research and development and production contracts were not effective; and implementation of the Air Force GFM financial accountability system had slipped and could have been further delayed because of unresolved issues.

GFM problems at contractor locations included excess GFM valued at $1.3 million at four of the 2 locations reviewed, the transfer of about $14 million in assets to other contracts without Air Force assessment of the appropriateness of the action, and the commingling of contractor material with GFM.

Army Audit Agency

Control over GFM, U.S. Army Bell Plant Activity (Nov. 1976)

Annual surveys of the contractor's property control system were not made. The contractor had problems in maintaining controls over GFM. Physical inventory of 37 high-dollar value items showed that adjustments of $1.4 million were needed on 20 items to make inventory records agree with on-hand balances.

Control over GFM at U.S. Army Electronics Command, Ft. Monmouth, N.J. (Feb. 1977)

Accounting procedures and controls were inadequate over GFM and did not provide the required financial control. Subsidiary accounting records for material by specific contracts were not established.

Control over GFM Aviation Items (July 1977)

Accounting controls over GFM were not adequate to prevent losses. Property administrators did not make annual property surveys. Inventory records used by contractors to account for GFM were inaccurate. Requisitioning and use of GFM were not adequately controlled. Adjustments of $1.5 million were needed on 56 high-dollar items to correct contractor's inventory records.

Government-Furnished Property, U.S. Army Plant Representative Office, Boeing Vertol Company, Philadelphia, Pa. (EC 83-601, Mar. 1983)

The contractor proposed building new special tools; however, he used some tools the Army already owned. This reduced the contractor's overall costs and could have led to the Army's paying about $1.7 million in incentive fees. Also, the contractor did not adequately identify or report excess government-furnished material. According to records, about $2 million of excess government-furnished material was on hand at the contractor's plant. A portion of the excess material could have been used to satisfy other Army needs.

Although the contractor had good accountability over government-furnished property, its internal controls over transactions dealing with government-furnished material rejected from the production line or sent to subcontractors were inadequate. The contractor had not returned about $146,700 of the government-furnished material to its government property unit. Many of the missing items were found commingled with contractor-owned stocks, increasing the potential for losses of Army material.

Government-Furnished Property, U.S. Army Plant Representative Office, Bell Helicopter--Textron, Fort Worth and Amarillo, Tx. (SW 83-600, Mar. 1983)

Management of government-furnished property in the functions reviewed was not adequate. Regulatory guidance related to government-furnished property was not always followed, and better management of government-furnished property in the hands of the contractor was needed. The need for replacing or transferring special test equipment to follow-on contracts was not validated. Required property surveys were not performed and accountability over government-furnished material was inadequate.

Government-Furnished Property, U.S. Army Aviation Research and Development Command and U.S. Army Troop Support and Aviation Material Readiness Command, St. Louis, Mo. (MW-83-602, May 1983)

The audit showed that analyses supporting the decisions to have the government provide materials to contractors were not made and documented. Also, excess material items at the contractor's plants were not adequately identified, reported, and used to reduce follow-on contract requirements. In addition, controls were not adequate to insure proper financial accountability and visibility over the property.

Audit of Government-Furnished Property
(EC 93-605, June 1983)

The management of government-furnished property in some functions was not adequate, and management improvements could have resulted in substantial cost savings. Contractors and Army property administrators were not adequately identifying and reporting excess government-furnished material. Procedures were not issued to help activities determine whether the government or the contractor should furnish property (needed or required) to fulfill the contract. The contractors did not always adequately account for and safeguard the property furnished by the government, and inventory losses occurred.

Annual property surveys of contractor internal control systems were not always performed or were not performed thoroughly enough to detect internal control weaknesses at contractor plants. Also, general and subsidiary ledger accounts for government-furnished property were not maintained. The balances were inaccurate and could not be used either as internal controls or to help maintain visibility over property provided to contractors.

Navy Inspector General

Supervisor of Shipbuilding, Conversion and Repair, USN, Boston, Mass. (May 1978)

There was no specific instruction on disposition of excess GFM in possession of contractors. The division was making a strong push to clear out fairly substantial amounts of GFM that had been gathering at contractor's plants over several years.

Supervisor Shipbuilding, Conversion, and Repair, USN, Newport News, Va. (November 1978)

Four SUPSHIPs and 14 contractor audits scheduled for calendar year 1978 were not conducted. The contractor was holding an estimated $8 million of excess government property. As of October 27, 1978, 200 excess defective repairable items were held by the contractor; 120 of these for more than 90 days.

Naval Audit Service

Supervisor of Shipbuilding Conversion and Repair, USN, Newport News Shipbuilding and Drydock Co., Newport News, Va. (Aug. 1976)

The contractor's system for controlling GFM did not satisfy requirements of the Armed Services Procurement Regulations as incorporated into shipbuilding contracts. The most recent inventory showed the total inventory on-hand value was $200 million. The approved system did not provide for periodic physical inventories.

Naval Plant Representatives' Office Long Beach, Calif. (Jan. 1978)

About $2.3 million of government-furnished aeronautical equipment in the hands of the contractor was excess and not effectively used by the Naval Air Systems Command. Review of the supply status showed outstanding current procurement actions valued at over $400,000 could have been avoided if the excesses had been turned in.

Supervisor of Shipbuilding, Conversion and Repair, Pascagoula, Mississippi (Mar. 1979)

There was no adequate procedure within the Navy for disseminating information as to what components furnished to private contractors as GFM were under warranty. GFM was not being administered in accordance with pertinent directives. For example, a property system survey plan was not developed and the annual system survey was not being done.

Fleet Combat Direction Systems Support Activity, Dam Neck, Virginia Beach, Va. (July 1979)

The contractor received 1,652 items of GFM with an estimated replacement cost of over $250,000. There was virtually no control over the property, since neither the contractor nor property administrator complied with the Defense Acquisition Regulations.

Multi-Location Audit of the Aviation Supply Offices' Management of GFM (Nov. 1979)

The audit service identified that about $10.6 million of GFM consumable material in the possession of contractors was excess to their needs. Excess material valued at about $1.1 million could have been used to satisfy 209 backordered requisitions, including 113 high priority requirements, and reduce or eliminate existing or planned procurements. An estimated $20 million of the total GFM identified in the possession of contractors may have been excess to contractor needs, and excesses valued at about $2.1 million could have been used to satisfy other system requirements. Overall, the Aviation Supply Office's management control over GFM was minimal and less than desirable. Consequently, the advantages of providing GFM were not being achieved.

Supervisor of Shipbuilding, Conversion, and Repair, USN Newport News, Va. (April 1980)

The contractor had not provided satisfactory revisions to his property control system 6 years after the audit. Required annual surveys of the system have not been conducted since 1977. Also, the contractor had not taken periodic physical inventories of all government property as required. Consequently, there was no assurance that government property in possession of the contractor was adequately controlled, preserved, and maintained.

Supervisor of Shipbuilding, Conversion and Repair, USN, Long Beach, Calif. (Mar. 1981)

SUPSHIP needed to improve inventory control procedures for excess GFM. No comprehensive list of all items was maintained, records did not show actual status, and items without an identified future need were not returned to the Navy Supply System.

Phase I of the Intraservice Audit of Government-Furnished Material in the Possession of Contractors and Grantees. (Aug. 1983)

Two contractors were provided about $1.1 billion of GFM under two contracts for the construction of aircraft carriers and submarines, but never performed physical inventories as required by the FAR.

Audit of Government-Furnished Property in the Possession of Contractors and Grantees--Phase II (G 20052, Sept. 1983)

This audit included work at Naval Plant Representatives Offices (NAVPRO) located at St. Louis, Missouri, and Pomona, California; at the Supervisor of Shipbuilding, Conversion and Repair at Groton, Connecticut; and the Naval Submarine Bases (SUBASE) at Bangor, Washington, and Kings Bay, Georgia.

The property control systems contractors used at SUBASE Bangor and NAVPRO Pomona to account for government-furnished property were not always adequate. Government representatives at these two activities as well as at SUPSHIP Groton did not perform the required checks of the integrity of contractors' property control systems. In some instances, adequate control over the acquisition of government-furnished property did not exist at the two SUBASEs and at the NAVPRO.

A Review of Procurement, Property and Other Selected Functions at the Supervisor of Shipbuilding, Conversion, and Repair USN. New Orleans, La. (June 1984)

SUPSHIP could not provide the specific dollar value of GFM two that had an estimated value that could exceed $75 million which were in the possession of two contractors. The reliability of the contractors' property systems was not assured since the property administration functions were not fully implemented.

Contract Administration, Procurement and Other Selected Functions at the Naval Plant Representative Office, Stratford, Conn. (May 1985)

A contractor with over $303 million of government property including $36 million of GFM, operated with outdated and incomplete property control procedures. Some of the procedures, which had been approved in the early 1970s, were not updated. As a result, there was no assurance that the property was adequately controlled.

Internal Controls, Contract Administration, Property Administration, and Financial Management at Naval Plant Representative Office, Laurel, Md. (Mar. 1986)

Navy oversight at a contractor who had $137 million of government property at a university and several remote locations was inadequate. Problems cited included (1) property surveys that were not performed at 6 remote locations that had $6.6 million of government property and (2) documentation that was not available to support the Navy's approval of the contractors property control system. One reason for not surveying the remote locations was the lack of property administration personnel.

Addendum to: Contract Administration, Procurement, and Other Related Functions at the Naval Plant Representative Office, St. Louis, Mo. (Aug. 1986)

A contractor retained $126 million of government property in support of aircraft programs that did not have any demand during a 12-month period. An additional $20 million of excess government property was identified that supported the contractor's missile program. About $50 million in potential savings could have been realized by redistributing or disposing of GFM inventories that appeared excess to requirements. The responsible Navy Command concurred with the results and agreed to (1) transfer $30 million of the excess inventory to other users, (2) dispose of $5 million because it was obsolete, and (3) review the remaining excesses to determine the benefits to be gained from redistribution and disposal.

Selected Aspects of Range Operations at the Pacific Missile Test Center Pt. Mugu, Calif. (Sept. 1986)

The Navy was deficient in its oversight of government-furnished property valued at $41.3 million provided to its contractors at the Navy's Pacific Missile Range Facility, Kekaha Kauai, Hawaii. The last annual property survey was performed in 1984, but survey documentation was only a brief narrative and did not include information necessary to support the conclusions reached concerning the adequacy of the contractor's controls. These conditions existed because a full-time property administrator had not been assigned to the contract.

Contract Administration Procurement, and Other Related Functions at the Naval Plant Representative Office, Bethpage, N.Y. (June 1987)

A contractor retained $114 million of material from completed contracts and held an additional $7 million, even though there had been no demand for the material for over 12 months. As a result, the government (1) may have acquired up to $121 million in unneeded material and (2) may have been unnecessarily charged for storage costs. The responsible Navy command agreed that of the $114 million, $36.7 million represented potential excess. The command claimed that the remainder was required by the contractor. The Naval Audit Service disagreed and requested that the Navy review the matter. The Navy-responsible command agreed that the additional $7 million was excess and requested disposition instructions.

Also, property administration was not performed or insufficiently performed to adequately evaluate the contractors' property system, which controlled $3.4 billion of government property located in 5 states and at 400 subcontractors. This deficiency was attributed to an insufficient number of government personnel assigned to property administration.

SUMMARIES OF CONGRESSIONAL REPORTS ON GOVERNMENT-FURNISHED MATERIAL

Report of the Subcommittee on Economy in Government, Joint Economic Committee, on "Economy in Government Procurement and Property Management" (April 23, 1968)

The report said the DOD must make a much greater effort to enforce its stated policy that contractors provide their own facilities and materials incident to the performance of government contracts. DOD has failed to establish adequate controls over the inventory of its approximately $15 billion of property furnished to contractors and contractors' accounting systems were found to not provide for financial control. In most instances, acceptable physical inventories of government-owned material were not being taken properly.

Report of the House Committee on Appropriations on "Department of Defense Appropriations Bill", 1979 (July 27, 1978)

The Committee was concerned that by allowing DOD maintenance contractors to requisition material from the government's supply system, abuses were possible and could take place. DOD's response to this situation was to add more people at contractor plants and inventory control points. The Committee believed that much of the problem could have been avoided simply by allowing contractors to use the supply system, but also requiring them to pay cash for materials requisitioned.

Report of the House Committee on Appropriations on "Department of Defense Appropriation Bill", 1980 (Sept. 20, 1979)

The report commented on the prior year report and noted that DOD was asked to undertake a test by restructuring a portion of the maintenance contracts to allow the contractor to use the Defense supply system on a cash basis rather than on a GFM basis.

The Committee directed DOD to test a cash payment program for the provisioning of consumable supplies on maintenance contracts. The Committee hoped that the test would (1) provide a check on the price of the government procured items because the contractors would not use the government system when they could buy the items from commercial sources at less cost; (2) prevent the contractors from ordering far more then they needed; (3) save manpower to police the system and expand new control mechanisms; and (4) eliminate unnecessary record-keeping.

Report of the House Committee on Government Operations; Subcommittee on Legislation and National Security Subcommittee on "Inadequate Control Over Government Material Furnished to DOD Contractors" (Dec. 10, 1981)

DOD has failed to adequately control billions of dollars worth of GFM provided to its contractors, and DOD's policy of relying almost solely on contractors for accounting controls for the GFM was ineffective. The lack of these controls led to GFM being provided in excess amounts to contractors, sold back to DOD, or used on commercial contracts.

DOD recognized that there was unauthorized access by contractors to the DOD supply system, misuse of GFM, and other losses of GFM because of a generally less than satisfactory system of control and accountability over GFM.

Recommendations included, among other things, that DOD

-- centralize management and accountability of GFM in one adequately staffed office,

-- test the practicability of selling material to contractors instead of providing it free of charge,

-- control production contractors' access to DOD's supply system, and

-- employ more property administrators assigned to contractors' plants and develop a plan to install accounting controls over GFM.

Report of the House Committee on Government Operations, Subcommittee on Legislation and National Security on "Costly Failure to Control Government Property Furnished to Defense Contractors Remains Uncorrected" (May 21, 1985)

Despite the continued criticism, DOD still lacked internal controls over much of the $40 billion worth of government-owned property in contractor hands. Implementation of existing regulations remained inadequately implemented. DOD was unable to control access to and account for much of this property, so contractors were able to acquire more than they needed or were entitled to under their contracts, to disregard obligations for proper maintenance, to lose property without penalty and use it in commercial production without renumerating the government.

The committee called for, (1) DOD's efforts to install appropriate accounting controls over GFM be accelerated, (2) plans for implementing the MCA concept contained in DODI 4140.48 be expedited, (3) the control requirements be extended from maintenance to production and supply contractors, and (4) the concept of selling material to contractors instead of providing it free of charge be retested.

Report of the House Committee on Government Operations, Subcommittee on Legislative and National Security on "Misuse of Government Equipment In Defense Production" (Apr. 29, 1986)

Defense and military services have a long way to go to achieve a substantial reduction in the costs of furnishing government equipment to defense contractors. Major factors impeding progress include:

- -- the vagueness of the FAR and the lack of adequate guidelines;
- -- limited Defense efforts to motivate contractors to provide their own equipment;
- -- lack of sales of government-owned plants;
- -- continuing management oversight problems at field and headquarters levels regarding the acquisition, use, retention, and disposal of GFM; and
- -- limited visibility over IPE, OPE and STE in the possession of contractors.

Recommendations included, among other things, that DOD speed up its efforts to install appropriate accounting controls over government-furnished property, including GFE.

QUESTIONS FOR GAO

1. QUESTION: MR. CONAHAN, HAS DOD DEVELOPED THE CAPACITY FOR DETERMINING HOW MUCH GOVERNMENT-FURNISHED PROPERTY IS ISSUED TO CONTRACTORS, HOW MUCH IS CURRENTLY ON-HAND, AND HOW MUCH IS IN EXCESS TO THE CONTRACTORS' NEEDS?

ANSWER: IN AUGUST 1986, DOD ESTABLISHED A DATA BASE SYSTEM CALLED THE "DEPARTMENT OF DEFENSE INDUSTRIAL PROPERTY MANAGEMENT SYSTEM." THIS SYSTEM IS TO PROVIDE MANAGERS WITH SUFFICIENT VISIBILITY TO ADEQUATELY MANAGE GOVERNMENT-OWNED PROPERTY. USING CONTRACTOR RECORDS, THAT ARE GENERALLY THE GOVERNMENT'S OFFICIAL PROPERTY RECORDS, THE SYSTEM TRACKS THE BEGINNING AND ENDING YEAR BALANCES AND THE ADDITIONS AND DELETIONS FOR ALL DOD PROPERTY CATEGORIES ON A CONTRACT-BY-CONTRACT BASIS. HOWEVER, IN THE GOVERNMENT MATERIAL AREA, THE SYSTEM DOES NOT CALL FOR REPORTING OF ADDITIONS AND DELETIONS DURING THE YEAR, BECAUSE DOD DID NOT CONSIDER COLLECTION OF SUCH DATA COST-EFFECTIVE.

INFORMATION WE OBTAINED DURING OUR RECENT REVIEW OF GOVERNMENT MATERIAL DISCLOSED THAT CONTRACTOR-PROVIDED DATA WAS INACCURATE AND INCOMPLETE. FOR EXAMPLE, THREE NAVY CONTRACTORS WE REVIEWED WITH MATERIAL VALUED AT ABOUT $22.5 MILLION ON THREE CONTRACTS HAD NOT SUBMITTED THE REQUIRED DATA FOR FISCAL YEARS 1986 AND 1987.

REGARDING EXCESS PROPERTY, THE CONTRACTORS HAVE THE RESPONSIBILITY FOR IDENTIFYING AND REPORTING GOVERNMENT PROPERTY EXCESS TO NEEDS. GOVERNMENT PROPERTY ADMINISTRATORS ARE TO ENSURE THAT THE CONTRACTORS FULLFIL THESE RESPONSIBILITIES. AS NOTED IN OUR TESTIMONY, CONTRACTOR REPORTING OF EXCESSES LEAVES A LOT TO BE DESIRED.

2. QUESTION: MR. CONAHAN, IN YOUR TESTIMONY YOU IDENTIFIED A NUMBER OF INSTANCES WHERE CONTRACTORS ACCUMULATED POTENTIAL EXCESS MATERIAL. IN YOUR OPINION, WHAT CAUSES THESE EXCESSES?

ANSWER: THE ACCUMULATION OF EXCESS MATERIAL AT CONTRACTOR PLANTS HAS BEEN A LONGSTANDING PROBLEM. BOTH OUR OFFICE AND DEFENSE AUDIT ORGANIZATIONS HAVE REPORTED ON THIS PROBLEM. DURING OUR RECENT REVIEWS, WE IDENTIFIED ABOUT $18.6 MILLION OF POTENTIAL EXCESS MATERIAL UNDER FOUR NAVY MAINTENANCE AND SERVICE CONTRACTS. SEVERAL FACTORS CONTRIBUTED TO THESE POTENTIAL EXCESSES. FIRST, IN SOME CASES, CONTRACTORS WERE NOT PROPERLY COMPUTING THE AMOUNTS NEEDED TO FULFILL CONTRACT REQUIREMENTS. SECOND, UNNEEDED MATERIAL FROM PRIOR CONTRACTS WAS NOT CONSIDERED IN IDENTIFYING AND FILLING REQUIREMENTS FOR CURRENT CONTRACTS. THIRD, CONTRACTORS AND DOD PROGRAM AND PROPERTY ADMINISTRATION OFFICES HAD NOT ESTABLISHED ADEQUATE PROCEDURES TO IDENTIFY EXCESS MATERIAL CONDITIONS.

3. QUESTION: MR. CONAHAN, WHY IS IT IMPORTANT FOR DOD TO HAVE VISIBILITY OVER GOVERNMENT-FURNISHED PROPERTY?

ANSWER: IN OUR OPINION, EFFECTIVE MANAGEMENT OVERSIGHT REQUIRES INFORMATION ON THE AMOUNT OF PROPERTY ON-HAND; ANNUALLY PROVIDED, USED, DISPOSED OF, OR RETURNED TO DOD; AND IN EXCESS OF NEEDS. SUCH INFORMATION CAN THEN BE USED TO ESTABLISH TRENDS, INVENTORY TURNOVER RATES, ETC.

THE NEED FOR MANAGEMENT VISIBILITY OVER GOVERNMENT PROPERTY HAS BECOME EVEN MORE URGENT SINCE DOD HAS COLLECTED DATA WHICH SHOWS THAT THE TOTAL VALUE OF PROPERTY ON-HAND AS OF SEPTEMBER 30, 1986 WAS OVER $45 BILLION. FURTHERMORE, EVIDENCE WE OBTAINED SHOWS THAT AMOUNT OF MATERIAL (WHICH IS THE LARGEST CATEGORY OF PROPERTY) IS SEVERAL TIMES LARGER THAN THE ON-HAND BALANCE.

4. QUESTION: MR. CONAHAN, IS DOD MEETING THE INTENT BEHIND THE FAR REQUIREMENT SPECIFYING THAT CONTRACTORS WOULD PROVIDE THE PROPERTY NECESSARY TO PERFORM GOVERNMENT CONTRACTS?

ANSWER: THE FAR REQUIRES CONTRACTORS TO FURNISH ALL PROPERTY NECESSARY TO PERFORM GOVERNMENT CONTRACTS UNLESS IT IS DETERMINED TO BE IN THE BEST INTEREST OF THE GOVERNMENT TO PROVIDE THE PROPERTY. THE FAR AND DOD AND SERVICE REGULATIONS FURTHER SPECIFY THAT DECISIONS TO PROVIDE ANY GOVERNMENT PROPERTY SHALL BE SUPPORTED BY SOUND RATIONALE AND SUPPORTED IN WRITING.

IN OUR PAST GFE AND GFM REVIEWS, WE FOUND VERY FEW INSTANCES WHERE GOVERNMENT CONTRACTING OFFICIALS COMPLIED WITH THE ESTABLISHED POLICIES. IN MOST INSTANCES, THE GOVERNMENT HAS INTERPRETED THE "BEST INTEREST" CLAUSE VERY LOOSELY AND HAS NOT ADEQUATELY DOCUMENTED THE BASIS FOR ANY EXCEPTIONS GRANTED. THIS HAS RESULTED IN THE ACQUISITION OF EQUIPMENT AND MATERIAL WHICH COULD OR WAS READILY OBTAINED FROM COMMERCIAL SOURCES, SOMETIMES AT LESS COST THAN IF IT HAD BEEN PROVIDED FROM GOVERNMENT SOURCES. PROPERTY ACQUIRED OVER THE YEARS HAS INCLUDED SUCH ITEMS AS OFFICE FURNITURE AND SUPPLIES, AUTOMOTIVE SUPPLIES, VEHICLES, AND PERSONAL COMPUTERS.

5. QUESTION: MR. CONAHAN, SHOULD THE OFFICIAL ACCOUNTING RECORDS FOR GOVERNMENT-FURNISHED PROPERTY BE MAINTAINED BY THE CONTRACTORS?

ANSWER: IT IS OUR POSITION THAT THE OFFICIAL GOVERNMENT PROPERTY RECORDS COULD BE MAINTAINED EITHER BY THE CONTRACTOR OR THE GOVERNMENT, BUT NOT BY BOTH. IN OUR OPINION, WHERE THE CONTRACTORS' CURRENTLY MAINTAIN THESE RECORDS, IT MAY BE MORE PRACTICAL TO CONTINUE THIS SYSTEM OF PROPERTY ACCOUNTING. HOWEVER, IN VIEW OF THE CONTINUING WEAKNESSES WE FOUND IN CONTRACTOR PROPERTY CONTROL SYSTEMS AND GOVERNMENT OVERSIGHT, DOD NEEDS TO STRENGTHEN ITS ENFORCEMENT OF THE FAR TO ENSURE THAT THE POTENTIAL FOR FRAUD, WASTE, AND ABUSE IS MINIMIZED AND THE GOVERNMENT'S INTERESTS ARE ADEQUATELY PROTECTED.

IN ADDITION TO BETTER ENFORCEMENT OF THE FAR, GAO ALSO BELIEVES AND DOD CONCURS THAT THE GOVERNMENT NEEDS TO HAVE A FINANCIAL PROPERTY ACCOUNTING SYSTEM THAT CAN PROVIDE GOVERNMENT OFFICIALS WITH INDEPENDENT DATA FOR IDENTIFYING DIFFERENCES BETWEEN GOVERNMENT AND CONTRACTOR RECORDS.

6. QUESTION: MR. CONAHAN, DID GAO FIND INSTANCES WHERE THE GOVERNMENT RATHER THAN THE CONTRACTOR MAINTAINED THE GOVERNMENT'S OFFICIAL PROPERTY RECORDS?

ANSWER: YES, WE FOUND TWO INSTANCES. AT THE DEFENSE LOGISTICS AGENCY'S PERSONNEL SUPPORT CENTER, THE GOVERNMENT TOOK OVER PROPERTY ACCOUNTABILITY FROM CLOTHING AND TEXTILE CONTRACTORS IN 1974. THE REASON FOR THIS CHANGE WAS THAT BETWEEN 1969 AND 1973, THE GOVERNMENT HAD DISPUTED IN COURT THE ACCURACY OF CONTRACTOR PROPERTY RECORDS AND THE CASES WERE DECIDED IN FAVOR OF THE GOVERNMENT ON THE BASIS OF THE GOVERNMENT'S DUPLICATE RECORDS. AS A RESULT, THE CENTER WAS GRANTED IN 1974 A FAR DEVIATION WHICH ALLOWED IT TO MAINTAIN THE GOVERNMENT'S OFFICIAL PROPERTY RECORDS.

AT THE NAVY, WE FOUND THAT THE MATERIALS NEEDED FOR ASSEMBLY AND REPAIR WERE STOCKED AT THE PLACE OF CONTRACT PERFORMANCE, BUT THE GOVERNMENT STILL MAINTAINED THE OFFICIAL PROPERTY RECORDS. THE CONTRACTOR DID NOT OBTAIN ANY MATERIAL UNTIL IT WAS ACTUALLY REQUIRED FOR USE. THIS MAY BE AN ALTERNATIVE CONTROL MECHANISM, BUT WE HAVE NOT STUDIED IT.

7. QUESTION: MR. CONAHAN, ARE DOD'S EFFORTS SUFFICIENT TO ASSURE THAT CONTRACTORS ARE PROVIDING ADEQUATE STEWARDSHIP OVER GOVERNMENT-FURNISHED PROPERTY?

ANSWER: AS EVIDENCED BY PRIOR GAO AND DEFENSE AUDIT REPORTS, GOVERNMENT OVERSIGHT OVER GOVERNMENT PROPERTY IN THE POSSESSION OF CONTRACTORS HAS GENERALLY BEEN INEFFECTIVE FOR MANY YEARS. WE FOUND SIGNIFICANT WEAKNESSES IN DOD AND SERVICE OVERSIGHT OVER THE ACQUISITION, USE, RETENTION, AND DISPOSAL OF GOVERNMENT PROPERTY. IN SOME INSTANCES, GOVERNMENT PROPERTY ADMINISTRATORS DID NOT PERFORM THE ANNUAL PROPERTY SURVEYS OF CONTRACTOR PROPERTY CONTROL SYSTEMS AS REQUIRED BY THE FAR AND, IN OTHER INSTANCES, NO GOVERNMENT PROPERTY ADMINISTRATORS WERE ASSIGNED TO OVERSEE CONTRACTOR PERFORMANCE.

8. QUESTION: MR. CONAHAN, IN YOUR OPINION WHAT WOULD BE THE IMPACT ON GOVERNMENT OVERSIGHT OVER GOVERNMENT PROPERTY, IF LESS WAS PROVIDED TO CONTRACTORS?

ANSWER: IN OUR OPINION, THE IMPACT WOULD BE SIGNIFICANT. FOR EXAMPLE, IF CONTRACTORS WERE NOT PERMITTED TO OBTAIN READILY AVAILABLE COMMERCIAL ITEMS, MOST OF WHICH ARE MANAGED BY THE DEFENSE LOGISTICS AGENCY (DLA), THE NUMBER OF MATERIAL REQUISITIONS SUBMITTED AND PROCESSED WOULD BE SIGNIFICANTLY REDUCED. DATA WE OBTAINED INDICATES THAT UP TO THREE-FOURTHS OF THE TOTAL NUMBER OF MATERIAL REQUISITIONS ARE FOR DLA-MANAGED ITEMS. THIS REDUCTION COULD ALSO BE EXPECTED TO TRANSLATE INTO LESS WORKLOAD FOR GOVERNMENT PROPERTY ADMINISTRATORS AND THE POTENTIAL FOR FEWER ITEMS BEING REPORTED AS EXCESS.

9. QUESTION: MR. CONAHAN, WHY HAS DOD BEEN UNABLE TO CORRECT THE LONGSTANDING PROBLEMS IN PROVIDING GOVERNMENT-FURNISHED PROPERTY?

ANSWER: IN PAST TESTIMONY BEFORE THE SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY, HOUSE GOVERNMENT OPERATIONS COMMITTEE, AND IN STATEMENTS TO GAO, DOD ACKNOWLEDGED THAT THE GOVERNMENT PROPERTY AREA HAS BEEN OF RELATIVELY LOW PRIORITY. FOR EXAMPLE, DOD HAS BEEN UNABLE TO ALLOCATE NEEDED PERSONNEL RESOURCES TO THE PROPERTY ADMINISTRATION FUNCTION DUE TO THIS LOW PRIORITY. IN ADDITION, GAO AUDITORS OBSERVED THAT PROPERTY ADMINISTRATORS WERE SOMETIMES DIVERTED TO PERFORM OTHER FUNCTIONS SUCH AS TRACKING DOWN MATERIAL AND LACKED ADEQUATE TRAINING.

ANOTHER FACTOR, ACCORDING TO DOD, HAS BEEN THE CONTRACTORS' RESISTANCE TO ANY CHANGES TO THE CURRENT PRACTICE OF THE GOVERNMENT PROVIDING MUCH OF THE PROPERTY NEEDED FOR CONTRACT PERFORMANCE. FOR EXAMPLE, IN A LIMITED 1983 DOD TEST WHICH ASKED CONTRACTORS TO PURCHASE MATERIAL REQUIRED FOR CONTRACT PERFORMANCE FROM THE GOVERNMENT SUPPLY SYSTEM, CONTRACTORS WERE RELUCTANT TO PARTICIPATE DUE TO THE FINANCIAL RISK INVOLVED.

10. QUESTION: MR. CONAHAN, DOES GAO SEE THE NEED FOR MAJOR CHANGES (PERHAPS THROUGH LEGISLATION) IN DOD'S POLICY OR IMPLEMENTATION WITH RESPECT TO GOVERNMENT-FURNISHED PROPERTY?

ANSWER: IN OUR OPINION, THE MAJOR PROBLEMS ASSOCIATED WITH GOVERNMENT-PROPERTY IS THE LACK OF IMPLEMENTATION AND ENFORCEMENT OF EXISTING GOVERNMENT POLICIES AND THE LACK OF INCENTIVES FOR CONTRACTORS TO EFFECTIVELY MANAGE THE GOVERNMENT PROPERTY IN THEIR POSSESSION. ALTHOUGH DOD HAS RECOGNIZED THESE PROBLEMS AND HAS RECENTLY INITIATED ACTIONS IN SOME AREAS, THE ACTIONS ARE FOCUSED ON ESTABLISHING NEW OR MODIFYING EXISTING POLICIES RATHER THAN ON IMPLEMENTATION OF EXISTING POLICIES.

DUE TO THE LONGSTANDING NATURE OF THE GOVERNMENT PROPERTY PROBLEMS AND THE LONG TIME IT TAKES TO MAKE AND IMPLEMENT FAR AND DOD POLICY CHANGES, SOME LEGISLATIVE INITIATIVES MAY BE HELPFUL. THESE INITIATIVES MAY BE IN SUCH AREAS AS (1) DEFINING THE CONDITIONS UNDER WHICH GENERAL PURPOSE EQUIPMENT AND MATERIAL READILY AVAILABLE FROM COMMERCIAL SOURCES CAN BE PROVIDED TO CONTRACTORS, AND (2) REQUIRING CONTRACT PROVISIONS THAT INCREASE CONTRACTOR INCENTIVES TO EFFECTIVELY MANAGE GOVERNMENT PROPERTY. FOR EXAMPLE, CONTRACTORS COULD BE HELD FINANCIALLY LIABLE FOR NOT PROMPTLY REPORTING EXCESSES OR NOT HAVING AN APPROVED PROPERTY CONTROL SYSTEM FOR AN EXTENDED PERIOD OF TIME.

11. QUESTION: MR. CONAHAN, DURING YOUR REVIEWS DID YOU FIND ANY INSTANCES WHERE CONTRACTORS WERE PROVIDED MATERIAL FROM THE DOD SUPPLY SYSTEM WITHOUT USING A CONTRACTOR IDENTIFICATION CODE? IF SO, WHAT ARE THE PROBLEMS THAT MAY BE ASSOCIATED WITH SUCH CIRCUMSTANCES?

ANSWER: YES, WE FOUND SEVERAL INSTANCES IN EACH OF THE SERVICES WHERE THE CONTRACTORS USED MILITARY UNIT IDENTIFICATION CODES TO REQUISITION MATERIAL. FOR EXAMPLE, WE FOUND THAT ON 15 CONTRACTS, 45 DIFFERENT IDENTIFICATION CODES WERE USED. OF THE 45 CODES, 42 WERE ASSOCIATED WITH MILITARY UNITS. IN THE AIR FORCE WE FOUND AT LEAST 21 MAJOR CONTRACTORS THAT USED MILITARY UNIT IDENTIFICATION CODES TO REQUISITION MATERIAL. SIMILAR CONDITIONS EXISTED WITHIN THE NAVY AT VARIOUS MILITARY INSTALLATIONS. HOWEVER, IN EACH CASE LOCAL OFFICIALS WERE AWARE THAT THE CONTRACTORS WERE USING THE MILITARY IDENTIFICATION CODES.

THE PRINCIPAL PROBLEM WITH USING MILITARY UNIT IDENTIFICATION CODES RATHER THAN CONTRACTOR CODES IS THAT THE SERVICES ARE NOT COMPLYING WITH MILITARY STANDARD REQUISITIONING AND ISSUE PROCEDURES. CONTRACTOR MATERIAL REQUISITIONS ARE TREATED AS MILITARY UNIT REQUISITIONS BY THE DOD SUPPLY SYSTEM AND, AS SUCH, BYPASS ALL CHECKS OR EDITS SPECIFICALLY ESTABLISHED TO CONTROL CONTRACTOR REQUISITIONS. UNDER THESE CONDITIONS CONTRACTORS COULD MATERIAL THAT WAS NOT AUTHORIZED UNDER THEIR CONTRACT.

12. QUESTION: OVERALL, WHAT IS YOUR REACTION TO THE REPORTING SYSTEM SET UP BY DOD TO GATHER THE ACQUISITION COSTS OF GOVERNMENT-FURNISHED PROPERTY PROVIDED TO DEFENSE CONTRACTORS? I KNOW THE SYSTEM IS TOO NEW FOR YOU TO COMMENT SPECIFICALLY ON ITS ACCURACY, BUT OVERALL DO YOU BELIEVE THE COSTS REPORTED ARE ABOUT ON TARGET, TOO LOW, OR TOO HIGH? ALSO, DO YOU SEE ANY PROCEDURAL FLAWS IN THE REPORTING SCHEME?

ANSWER: I BELIEVE THAT THE NEW REPORTING SYSTEM IS A BIG STEP FORWARD IN DETERMINING HOW MUCH GFP IS IN THE HAND OF CONTRACTORS. HOWEVER, AS STATED IN OUR TESTIMONY, WE HAVE CONCERNS WITH THE ACCURACY AND COMPLETENESS OF THE DATA MAKING UP THE REPORT. FOR EXAMPLE, 3 NAVY CONTRACTORS WE REVIEWED WHO HAD ABOUT $21.5 MILLION OF GFM IN THEIR POSSESSION, HAD NOT REPORTED THE NECESSARY DATA. ANOTHER NAVY CONTRACTOR WHO HAD REPORTED, OMITTED 2 CONTRACTS WITH MATERIAL VALUED AT $22.5 MILLION. HE ALSO DID NOT INCLUDE GFM VALUES OF OVER 56,500 LINE ITEMS OUT OF A TOTAL OF OVER 65,700 LINE ITEMS. THE VALUE OF THE REMAINING LINE ITEMS WAS ABOUT $59.6 MILLION. BECAUSE OF THE INCOMPLETE REPORTING AND DATA INACCURACIES, WE BELIEVE THE ON-HAND TOTALS IN THE NEW DOD REPORTING SYSTEM ARE PROBABLY STILL TOO LOW.

WE ARE CONCERNED THAT THE DOD REPORT DOES NOT PROVIDE DATA ON THE AMOUNT OF GOVERNMENT MATERIAL ADDED (ACQUIRED) AND DELETED (USED, RETURNED, OR DISPOSED OF) DURING A FISCAL YEAR. THE AMOUNT OF MATERIAL ADDED AND DELETED IS IN THE BILLIONS. WE BELIEVE THAT SUCH INFORMATION IS DESIRABLE FOR SEVERAL REASONS. FOR EXAMPLE, THE INFORMATION CAN BE USED TO IDENTIFY CONTRACTS (1) WITH POTENTIAL EXCESS MATERIAL BY RELATING ON-HAND BALANCES TO ADDITIONS AND DELETED AND (2) WHERE MATERIAL HAS BEEN PROVIDED ALTHOUGH THE WORK HAS BEEN COMPLETED.

13. QUESTION: IN YOUR RECENT WORK YOU CONCENTRATED ON CONTROLS OVER PROVIDING AND ACCOUNTING FOR GOVERNMENT-FURNISHED MATERIAL TO SERVICE AND MAINTENANCE TYPE CONTRACTORS AND FOUND SERIOUS PROBLEMS. ARE THOSE SAME PROBLEMS APPLICABLE TO PRODUCTION CONTRACTORS?

ANSWER: YES THEY ARE. IN OUR EARLIER WORK AND AS POINTED OUT IN THE NAVY'S EARLIER TESTIMONY, THE NAVAL AUDIT SERVICE RECENTLY REVIEWED THE MANAGEMENT AND CONTROL OF MATERIAL FURNISHED BY THE NAVY TO PRODUCTION CONTRACTORS AND FOUND SERIOUS PROBLEMS. FOR EXAMPLE, AT TWO PRODUCTION CONTRACTOR LOCATIONS THE NAVAL AUDIT SERVICE IDENTIFIED ABOUT $268 MILLION OF POTENTIAL EXCESS GFM. ALSO, THE NAVAL AUDIT SERVICE DISCLOSED DEFICIENCIES IN THE TWO CONTRACTOR'S PROPERTY CONTROL SYSTEMS AND IN THE GOVERNMENT'S OVERSIGHT OF THE SYSTEMS. SPECIFICALLY, FOR ONE OF THE CONTRACTOR'S THAT CONTROLLED $3.4 BILLION OF GOVERNMENT-FURNISHED PROPERTY LOCATED IN 5 STATES AND AT ABOUT 400 SUBCONTRACTORS, THE AUDIT SERVICE SAID THAT PROPERTY ADMINISTRATION WAS NOT PERFORMED OR INADEQUATELY PERFORMED.

14. QUESTION: DO YOU BELIEVE THE FAR NEEDS TO BE CLARIFIED ON FURNISHING GOVERNMENT PROPERTY? IF SO, WHAT TYPE OF CHANGES WOULD YOU SUGGEST?

ANSWER: WE BELIEVE THAT THE EXCEPTIONS IN THE FAR FOR PROVIDING GFP ARE TOO BROAD. IN OUR JUNE 1986 REPORT ON GFE WE NOTED THAT THE FAR CRITERIA WAS VERY VAGUE AND THAT THIS ALLOWED GOVERNMENT OFFICIALS TO PROVIDE ALMOST ANY SORT OF EQUIPMENT THAT THEY DECIDED WAS NEEDED UNDER THE CONTRACT INCLUDING SUCH ITEMS AS OFFICE FURNITURE, VEHICLES, AND PERSONAL COMPUTERS. FURTHERMORE, WE NOTED THAT THE ACTIONS ON THE EXCEPTIONS, AS WELL AS THE DOCUMENTATION WITH RESPECT TO THEM, HAD BEEN DELEGATED TO THE LOWEST LEVELS IN THE ORGANIZATION SUCH AS CONTRACTING OFFICERS AND PROGRAM MANAGERS. AS YOU KNOW, WHEN YOU GET TO THIS LEVEL IN THE ORGANIZATION THE EMPHASIS IS ON SCHEDULE AND LITTLE ATTENTION IS GIVEN TO SUCH THINGS AS WHETHER OR NOT THERE ARE BETTER WAYS OF DOING IT.

IN OUR REPORT ON GOVERNMENT MATERIAL WE FOUND A SIMILAR SITUATION. AGAIN, GOVERNMENT OFFICIALS ROUTINELY PROVIDED MATERIAL TO CONTRACTORS UNDER THE PRESUMPTION THAT IT WAS INHERENTLY LESS COSTLY AND TROUBLESOME FOR THE GOVERNMENT TO PROVIDE THE MATERIAL THAN FOR CONTRACTORS TO BUY IT. MATERIAL PROVIDED IN THIS FASHION INCLUDED SUCH READILY AVAILABLE

COMMERCIAL ITEMS AS PAINT, LUMBER, OFFICE AND AUTOMOTIVE SUPPLIES, AND VIDEOTAPES.

TO CHANGE THIS SITUATION, CHANGES IN THE FAR AND THE DEFENSE SUPPLEMENT TO THE FAR ARE REQUIRED WHICH LIMIT THE PROVISIONING OF GFP. FOR EXAMPLE, IN THE GFE AREA WE RECOMMENDED THAT THE DEFENSE SUPPLEMENT BE CHANGED TO ALLOW THE MILITARY SERVICES TO PROVIDE GENERAL PURPOSE EQUIPMENT TO CONTRACTORS ONLY UNDER HIGHLY UNUSUAL CIRCUMSTANCES WHICH ARE CLEARLY DEFINED, ADEQUATELY CONTROLLED, AND PROPERLY JUSTIFIED. A SIMILAR CLAUSE COULD BE INCORPORATED ON MATERIAL THAT IS READILY AVAILABLE FROM COMMERCIAL SOURCES.

15. QUESTION: THE ISSUE OF ACCOUNTABILITY HAS BEEN A THORNY ONE FOR SOMETIME. FROM THE PERSPECTIVE OF GOOD BUSINESS PRACTICE, IT SEEMS TO BE POOR POLICY TO DEPEND ON THE PEOPLE RECEIVING FREE MATERIAL AND EQUIPMENT TO ADEQUATELY ACCOUNT FOR IT WITHOUT THE GOVERNMENT HAVING A GOOD WAY TO ENSURE THAT THEY ARE DOING A GOOD JOB. ON THE OTHER HAND, DOD HAS SAID FOR A NUMBER OF YEARS THAT IT IS TOO COSTLY FOR DOD TO TAKE ON THIS RESPONSIBILITY. HOW CAN THIS DILEMMA BE SOLVED?

ANSWER: THE SOLUTION TO THIS DILEMMA LIES IN HAVING DOD DEVELOP AN APPROPRIATE SYSTEM ALONG WITH NECESSARY CONTROLS AND INTERFACES TO ESTABLISH FINANCIAL ACCOUNTABILITY AND AN AUDIT TRAIL FOR RECONCILING DIFFERENCES BETWEEN THE DEPARTMENT AND CONTRACTOR RECORDS. FOR ABOUT 20 YEARS, GAO AND THE DEFENSE AUDIT AGENCIES HAVE CONTINUOUSLY REPORTED PROBLEMS IN ACCOUNTING FOR AND CONTROLLING GFP. MOREOVER, CONCERNS ABOUT GFP HAVE NOT BEEN LIMITED TO THE AUDIT ORGANIZATIONS. THE PRESIDENT'S COUNCIL ON INTEGRITY AND EFFICIENCY IN 1983 REPORTED ON WEAKNESSES IN THE GOVERNMENT'S CONTROL OVER PROPERTY HELD BY CONTRACTORS. FOR EXAMPLE, THEY FOUND THAT CONTRACTORS HELD OVER $30 MILLION IN GFP NOT NEEDED FOR CONTRACT PERFORMANCE.

DOD HAS TAKEN THE INITIAL STEPS TO ESTABLISHING FINANCIAL ACCOUNTABILITY BY PUBLISHING THE ACCOUNTING SYSTEMS MANUAL DOD 7220.9-M IN OCTOBER 1983. ACCORDING TO THE MANUAL, THE

FINANCIAL ACCOUNTING SYSTEM WILL CONTAIN GFP DATA BY CONTRACTOR AND INCLUDE THE BOOK VALUE OF GFP SHIPPED OR OTHERWISE FURNISHED TO CONTRACTORS AS WELL AS THE GFP REPORTED BY CONTRACTORS AS USED, RETURNED, OR DISPOSED OF. WE SUPPORT THE NEED FOR SUCH INFORMATION.

ONCE DOD HAS ESTABLISHED THESE FINANCIAL RECORDS WHICH WOULD PROVIDE SUMMARY INFORMATION ON GFP, THEY COULD BE COMPARED TO THE PROPERTY CONTROL RECORDS MAINTAINED BY THE CONTRACTORS TO MAINTAIN EFFECTIVE CONTROL OVER PROPERTY FURNISHED TO CONTRACTORS.

REGARDING THE ISSUE OF COST TO DEVELOP THE REQUIRED FINANCIAL ACCOUNTING SYSTEMS, WE UNDERSTAND THAT THE SERVICES HAVE BEEN REQUESTED BY THE DOD COMPTROLLER STAFF TO PROVIDE AN ESTIMATE OF THE ACTUAL COST TO DEVELOP AND IMPLEMENT SUCH SYSTEMS. WE DO NOT KNOW WHETHER SUCH COST ESTIMATES HAVE BEEN PROVIDED.

16. QUESTION: WHAT DO YOU CONSIDER TO BE THE MOST SERIOUS DISADVANTAGES OF PROVIDING GOVERNMENT PROPERTY FREE OF CHARGE TO CONTRACTORS?

ANSWER: THERE ARE SEVERAL DISADVANTAGES OF PROVIDING GOVERNMENT PROPERTY TO CONTRACTORS. FIRST, CONTRACTORS FACE NO FINANCIAL RISKS IN USING THE PROPERTY AND HAVE NO INCENTIVE TO MINIMIZE ITS USE. SINCE THE PROPERTY IS NOT FINANCED BY CONTRACTORS, THEY EXPERIENCE NO PENALTY FOR OVERORDERING OR OVERSTOCKING IT. ON THE OTHER HAND, THE GOVERNMENT INCURS UNNECESSARY COSTS BY (1) SHIPPING THE PROPERTY FROM SUPPLY POINTS TO CONTRACTORS AND VICE VERSA WHEN THE PROPERTY IS IDENTIFIED AS EXCESS TO THE CONTRACTORS' NEEDS; (2) HAVING TO PROVIDE ADDITIONAL ITEMS TO SATISFY THE REQUIREMENTS OF OTHER CUSTOMERS; AND (3) HAVING TO PROCESS THE EXCESS PROPERTY THROUGH PLANT CLEARANCE. ALSO, BY THE TIME THE PROPERTY IS IDENTIFIED AS EXCESS, IT IS OFTEN OBSOLETE AND CAN ONLY BE SOLD AT A FRACTION OF ITS ORIGINAL COST.

SECOND, ACCOUNTING AND CONTROLLING FOR PROPERTY AT CONTRACTOR LOCATIONS IS DIFFICULT AND COSTLY. FOR EXAMPLE, BASED ON A REVIEW OF 15 CONTRACTS, THE AIR FORCE AUDIT AGENCY REPORTED IN 1987 THAT TOTAL CONTRACTOR DIRECT COSTS ASSOCIATED WITH AIR FORCE GFM REPORTING REQUIREMENTS ALONE AMOUNTED TO OVER $500,000.

THIRD, CONTRACTORS HAVE NO INCENTIVE FOR OBTAINING THE PROPERTY, EVEN WHEN THE PROPERTY COULD BE OBTAINED COMMERCIALLY AND AT A LOWER PRICE. IN OUR RECENT WORK, WE FOUND TWO CONTRACTORS WHO WERE ABLE TO OBTAIN MATERIAL AT LOWER COST BECAUSE OF UNIQUE CONTRACT PROVISIONS WHICH PERMITTED THEM TO OBTAIN MATERIAL FROM OTHER THAN GOVERNMENT SOURCES WHEN IT WAS MORE ECONOMICAL TO DO SO.

17. QUESTION: DO YOU CONCUR THAT GOVERNMENT-FURNISHED MATERIAL AND OTHER PLANT EQUIPMENT ARE PROBABLY THE MOST DIFFICULT TO ACCOUNT FOR AND THE MOST LIKELY TO BE MISUSED? DO YOU BELIEVE THAT THIS TYPE OF PROPERTY SHOULD BE SUBJECTED TO MORE STRINGENT CONTROLS THAN OTHER GOVERNMENT-FURNISHED PROPERTY?

ANSWER: IT DEPENDS. IF THE MATERIAL OR OTHER PLANT EQUIPMENT IS LARGE OR OF A HIGH DOLLAR VALUE SUCH AS A NUCLEAR REACTOR, AN AIRCRAFT ENGINE, OR A FORKLIFT, DOD HAS PRETTY GOOD VISIBILITY. HOWEVER, FOR SMALL ITEMS SUCH AS NUTS, BOLTS, OFFICE FURNITURE, AND AUTOMOTIVE SUPPLIES, MANY OF WHICH ARE OF A PILFERABLE NATURE, DOD HAS HAD DIFFICULTY MAINTAINING ADEQUATE VISIBILITY AND CONTROL. THIS AREA OFFERS THE GREATEST POTENTIAL FOR FRAUD, WASTE, AND ABUSE.

SINCE MOST OF THE PROPERTY THAT FALLS IN THE SECOND CATEGORY IS GENERALLY READILY AVAILABLE FROM COMMERCIAL SOURCES, CONTRACTORS SHOULD BE REQUIRED TO FURNISH THIS KIND OF PROPERTY UNLESS THEY CAN CLEARLY DEMONSTRATE IN WRITING THAT IT IS IN THE GOVERNMENT'S BEST INTEREST TO PROVIDE IT.

18. DO YOU HAVE A PERSPECTIVE ON WHY THE CONTRACT ADMINISTRATION FUNCTION HAS BEEN SO WEAK FOR SO LONG? REALISTICALLY, HOW CAN THIS PROBLEM BE FIXED?

ANSWER: THERE ARE SEVERAL REASONS WHY THE CONTRACT ADMINISTRATION FUNCTION IS WEAK. FIRST, DOD HAS ASSIGNED RELATIVELY LOW PRIORITY TO THIS AREA. FOR EXAMPLE, THE AREA OF PROPERTY ADMINISTRATION HAS SUFFERED FOR SOMETIME FROM THE LACK OF ADEQUATELY TRAINED PERSONNEL. DOD HAS RECOGNIZED THIS AND IN 1986 DIRECTED THE SERVICES TO REALIGN EXISTING RESOURCES TO PROVIDE FOR ADEQUATE STAFFING OF THIS AREA.

SECOND, IN OUR 1986 REVIEW OF THE CAPABILITY OF THE DEFENSE ACQUISITION WORKFORCE WE REPORTED THAT WHILE THE CONTRACTING OFFICER'S ROLE WAS CLEAR IN POLICY, IT DIVERGES SO WIDELY IN BOTH PRACTICE AND PERCEPTION THAT IT BRINGS INTO QUESTION WHAT THE FUNDAMENTAL POLICY IS OR SHOULD BE.

THIRD, IN THE SAME REVIEW WE FOUND THAT LITTLE EMPHASIS IS PLACED ON PROVIDING CONTRACTING OFFICERS WITH SPECIALIZED (PROGRAM OFFICE OR PRODUCT) EXPERIENCE AND THE SELECTION OF CONTRACTING OFFICERS WAS NOT BASED ON SPECIFIC EXPERIENCE, EDUCATIONAL, AND/OR TRAINING CRITERIA.

18A. QUESTION: DO YOU HAVE A PERSPECTIVE ON WHY THE PROPERTY ADMINISTRATION FUNCTION HAS BEEN WEAK FOR SO LONG? REALISTICALLY, HOW CAN THIS PROBLEM BE FIXED?

ANSWER: THERE ARE SEVERAL REASONS, WHY THE PROPERTY ADMINISTRATION FUNCTION HAS BEEN SO WEAK. FIRST, DOD HAS ASSIGNED OVER THE YEARS A RELATIVELY LOW PRIORITY TO THIS AREA AND, AS A RESULT, IT HAS SUFFERED FOR SOME TIME FROM THE LACK OF ADEQUATELY TRAINED PERSONNEL. DOD HAS RECOGNIZED THIS AND IN NOVEMBER 1986 DIRECTED THE SERVICES TO REALIGN EXISTING RESOURCES TO PROVIDE ADEQUATE STAFFING OF THIS AREA.

SECOND, THE SALARIES AND CAREER OPPORTUNITIES FOR PROPERTY ADMINISTRATORS (1103 SERIES) ARE LIMITED. FOR EXAMPLE, OF 328 PROPERTY ADMINISTRATION PERSONNEL ON BOARD IN MARCH 1987 IN DLA'S DEFENSE CONTRACT ADMINISTRATION SERVICE, ONLY 7 WERE GS-13S. THE REMAINDER WERE GS-5S TO GS-12S WHO EARNED BETWEEN $15,000 AND $43,000 PER YEAR. IN CONTRAST, CONTRACTOR PROPERTY ADMINISTRATORS CAN EARN MUCH MORE. FOR EXAMPLE, WE WERE TOLD THAT THEY COULD MAKE AS MUCH AS $75,000 PER YEAR.

A CONSEQUENCE OF THESE CAREER AND SALARY LIMITATIONS HAS BEEN A SIZEABLE TURNOVER RATE. FOR EXAMPLE, 37 PERCENT DLA'S PROPERTY ADMINISTRATION POSITIONS TURNED OVER BETWEEN MAY 1985 AND MARCH 1987. MANY OF THE TOP PROPERTY ADMINISTRATORS

REPORTEDLY JOINED CONTRACTORS OR LEFT THE PROFESSION ALTOGETHER.

THIRD, THE TRAINING OF PROPERTY ADMINISTRATORS MAY BE INADEQUATE. SERVICE AND DLA OFFICIALS TOLD US THAT CURRENT PROPERTY ADMINISTRATION COURSES TEACHING PROPERTY ADMINISTRATORS WHAT THEIR RESPONSIBILITIES ARE INSTEAD OF FOCUSING ON PRACTICAL APPLICATIONS.

FIXES TO THE PROBLEM ARE RELATED TO THE LEVEL OF MANAGEMENT ATTENTION GIVEN TO THIS AREA. THE 1986 DOD DIRECTIVE TO THE SERVICES IS CERTAINLY A STEP IN THE RIGHT DIRECTION. IN ADDITION, WE BELIEVE THAT DOD NEEDS TO CAREFULLY STUDY THE TRAINING AND CAREER LADDER FOR PROPERTY ADMINISTRATORS TO ENSURE DOD CAN MAINTAIN A CADRE OF ADEQUATELY TRAINED AND PAID PROPERTY ADMINISTRATORS.

19. QUESTION: HOW DO YOU ASSESS DOD'S CORRECTIVE ACTIONS TO DATE AND DO YOU BELIEVE ADDITIONAL CORRECTIVE ACTIONS ARE NECESSARY?

ANSWER: AS DISCUSSED IN OUR TESTIMONY DOD AND THE SERVICES HAVE TAKEN A SERIES OF ACTIONS TO ADDRESS THE PROPERTY MANAGEMENT AND CONTROL PROBLEMS OUR RECOMMENDATIONS MADE IN PAST AUDIT REPORTS. THE MOST SIGNIFICANT ACTION WAS THE NOVEMBER 1986 DOD PROPERTY POLICY GUIDANCE MEMORANDUM FOR IMPROVING THE MANAGEMENT OF ALL CATEGORIES OF GOVERNMENT PROPERTY IN THE POSSESSION OF CONTRACTORS. DOD IDENTIFIED 30 PROPERTY INITIATIVES THAT NEEDED TO BE IMPLEMENTED. WHILE DOD AND THE SERVICES SHOULD BE COMMENDED FOR TAKING THESE INIATIVES, WE ARE CONCERNED THAT THE EMPHASIS APPEARS TO BE ON EITHER ESTABLISHING NEW POLICIES AND PROCEDURES OR MODIFYING EXISTING ONES RATHER THAN ON IMPLEMENTATION.

STATEMENT
BY
ROBERT B. COSTELLO
UNDER SECRETARY OF DEFENSE
(ACQUISITION)

BEFORE THE
COMMITTEE ON GOVERNMENT AFFAIRS
UNITED STATES SENATE
ON
MARCH 21, 1988

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE YOU TO DISCUSS HOW WE MANAGE GOVERNMENT FURNISHED PROPERTY AND MATERIAL.

HERE WITH ME IS MR. JIM KORDES, ASSISTANT FOR INDUSTRIAL POLICY, AND MR. JIM RAY, DIRECTOR FOR SUPPLY MANAGEMENT AND POLICY.

SINCE I HAVE BEEN IN THE OFFICE OF THE UNDER SECRETARY OF DEFENSE FOR ACQUISITION, FIRST AS THE ASSISTANT SECRETARY OF DEFENSE FOR PRODUCTION & LOGISTICS, AND NOW AS THE UNDER SECRETARY OF DEFENSE FOR ACQUISITION, WE HAVE ISSUED A MAJOR POLICY ON GOVERNMENT-OWNED PROPERTY. IT LAID OUT OVER 30 AREAS IN OUR PROPERTY MANAGEMENT PROGRAM WE ARE IMPROVING. WE HAVE ISSUED THREE MEMORANDA (ATTACHED) OUTLINING THESE THIRTY AREAS, ESTABLISHING A TRACKING SYSTEM, AND PROVIDING MILESTONES. CURRENTLY, WE ARE CONTINUING TO GATHER DATA, AND WILL HAVE A DETAILED REPORT AVAILABLE THIS SUMMER. IN THE INTERIM, THE SERVICES CONTINUE TO REVIEW OVER 20,000 CONTRACTS FOR OBSOLETE AND EXCESS PROPERTY AND UNALLOWABLE FEES THAT MIGHT HAVE BEEN PAID ON THESE CONTRACTS.

THE AMOUNT OF PROPERTY IDENTIFIED IN THE POSSESSION OF CONTRACTORS, AS OF SEPTEMBER 30, 1987, IS VALUED AT $51.3 BILLION (SEE ATTACHED CHART). USING OUR NEW STEP-BY-STEP REPORTING PROCEDURES, WE ARE IDENTIFYING ALL GOVERNMENT PROPERTY. DOD MANAGERS AND AUDITORS OVERSEE THIS PROCESS, AND OUR CONTRACTORS CERTIFY ITS ACCURACY.

SOME MAY QUESTION THE VALIDITY OF HAVING OUR CONTRACTORS CERTIFY THESE RECORDS. WHILE THERE ARE SOME DOCUMENTED CASES OF MISMANAGEMENT AND THEFT, THEY ARE FEW IN NUMBER AND WE TAKE APPROPRIATE CORRECTIVE ACTION IN EVERY ONE OF THESE CASES. HOWEVER, OUR PAST PROBLEMS DO NOT LIE ONLY WITH OUR CONTRACTORS. UNTIL WE FOCUSED TOP MANAGEMENT ATTENTION ON THIS PROBLEM -- WHICH IS WHY I AM HERE TODAY -- WE, WITHIN THE DEPARTMENT, WERE ALSO CULPABLE.

DEPARTMENT MANAGEMENT HAS PAID ATTENTION AND HAS BEGUN A NUMBER OF IMPROVEMENTS. SOME OF THEM INCLUDE THE FOLLOWING.

"NO COST" STORAGE AGREEMENTS ARE NOW BEING ELIMINATED. RATHER THAN STORING OLD AND OBSOLETE PROPERTY, WE ARE NOW DISPOSING OF OBSOLETE PROPERTY AND REDUCING INDIRECT CONTRACT COSTS THAT WE PREVIOUSLY PAID TO STORE THIS PROPERTY.

WE ARE BEGINNING TO RECOUP UNALLOWABLE PROFITS THAT WERE PAID TO CONTRACTORS FOR ACQUIRING PLANT EQUIPMENT ON GOVERNMENT ACCOUNTS.

WE ARE ALSO ACTIVELY PURSUING THE NEGOTIATED SALE OF GOVERNMENT-OWNED PLANTS TO USING CONTRACTORS. THE AIR FORCE, FOR EXAMPLE, HAS INITIATED EFFORTS TO SELL ITS REMAINING 13 GOVERNMENT-OWNED CONTRACTOR-OPERATED PLANTS. SINCE 1974 THE NUMBER OF GOVERNMENT-OWNED CONTRACTOR-OPERATED PLANTS HAS BEEN REDUCED FROM 92 TO 64.

THE DEPARTMENT OF DEFENSE INSPECTOR GENERAL, AT OUR REQUEST, PERFORMED AN "OTHER PLANT EQUIPMENT" (E.G., GENERATORS, OVERHEAD CRANES, DESKS, CHAIRS, AND DESK TOP COMPUTERS) AUDIT TO ESTABLISH A BASELINE AND RECOMMENDATIONS FOR IMPROVED POLICIES. WE

CONCURRED WITH ALL OF THE FINDINGS AND RECOMMENDATIONS AND ARE AGGRESSIVELY IMPLEMENTING THEM.

ADDITIONALLY, OUR PROPERTY REPORTING SYSTEM INDICATES THAT $12.4 BILLION OF THE TOTAL GOVERNMENT FURNISHED PROPERTY FIGURE IS "GOVERNMENT FURNISHED MATERIALS," WHICH OFTEN CONSISTS OF WEAPONS SYSTEM PARTS AND COMPONENTS THAT HAVE BEEN PURCHASED DIRECTLY BY THE GOVERNMENT. (AN ATTACHED CHART SHOWS GOVERNMENT MATERIAL PROVIDED TO CONTRACTORS BY THE PURPOSE OR TYPE OF THE CONTRACT. THIS DATA IS ANOTHER PRODUCT OF OUR NEW PROPERTY REPORTING SYSTEM WE ESTABLISHED.) THE DEPARTMENT SHOULD CONTINUE TO PROVIDE MATERIEL LIKE JET ENGINES, BECAUSE IT REDUCES COST THROUGH ELIMINATING CONTRACTOR OVERHEAD AND FEES. IN 1987, THROUGH "BREAK-OUT" CONTRACTS FOR SPARE PARTS, WE SAVED OR AVOIDED OVER ONE HALF BILLION DOLLARS IN COSTS.

TO SAFEGUARD THESE SAVINGS, WE MUST INSURE THAT CONTRACTORS' ACCESS TO DOD MATERIAL INVENTORIES IS PROPERLY CONTROLLED. AT THIS COMMITTEE'S REQUEST, THE GAO RECENTLY COMPLETED FOUR AUDITS EXAMINING DOD ACTIONS

TO CONTROL CONTRACTOR ACCESS TO DOD MATERIAL INVENTORIES. IN GENERAL, THE DEPARTMENT AND THE GAO BELIEVE OUR PROCEDURES ARE ON TARGET; BUT THE FINAL TEST OF THESE MEASURES WILL OCCUR ONLY AFTER THESE PROCEDURES ARE FULLY IMPLEMENTED. THIS IS AN ITERATIVE PROCESS THE IMPLEMENTATION OF WHICH IS BASED ON THE CONTRACT IN FORCE OR THE DATE WHEN THE AUTOMATED MANAGEMENT CONTROL ACTIVITIES (WHICH REVIEW AND VALIDATE ALL GOVERNMENT FURNISHED MATERIAL REQUISITIONS) WILL BE FULLY OPERATIONAL. THIS PROCESS COINCIDES WITH THE SEMIANNUAL CYCLES FOR IMPLEMENTING MAJOR CHANGES TO THE STANDARD REQUISITIONING SYSTEM. HOWEVER, ALL MANAGEMENT CONTROL ACTIVITIES WILL BE ESTABLISHED AND OPERATING IN 1989.

IN CONCLUSION, WE OPERATE THE LARGEST SUPPLY SYSTEM IN THE WORLD. INVENTORY CONTROL IS A MAJOR RESPONSIBILITY FOR US AND WE HAVE POLICIES IN PLACE TO ADDRESS EACH AREA OF MATERIEL MANAGEMENT. FOR CRITICAL ITEMS, SUCH AS MUNITIONS, OUR RECORD IS OUTSTANDING. AND NOW, OUR POLICIES ON TRACKING GOVERNMENT FURNISHED PROPERTY HAVE ALSO BEEN MARKEDLY IMPROVED. WE ARE NOW FOLLOWING THROUGH ON

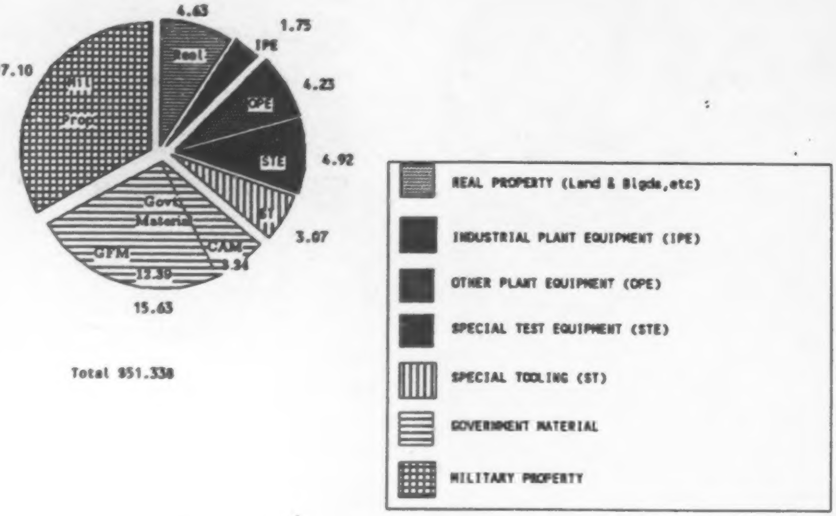
IMPLEMENTING THESE POLICIES AND MONITORING THE SERVICES' PERFORMANCE. WE CAN'T AFFORD NOT TO; OUR SUPPLIES NOT ONLY REPRESENT AN INVESTMENT IN TERMS OF DOLLARS, BUT MORE IMPORTANTLY, AN INVESTMENT TERMS OF OUR COMBAT READINESS.

THIS CONCLUDES MY PREPARED STATEMENT. I AM AVAILABLE TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.

DEFENSE INDUSTRIAL PROPERTY WITH CONTRACTORS

Dollars (in billions at acquisition cost)

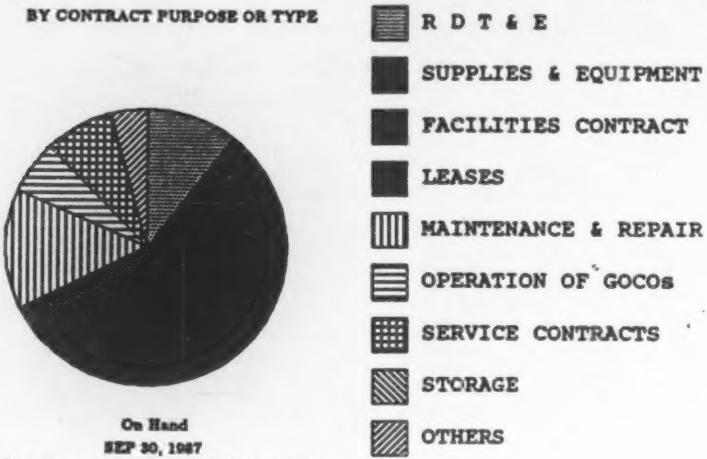
30 SEP 87



Source: Report of Government Property in the Custody of Contractors as of 30 Sep 1987, DD Form 1662.

GOVERNMENT MATERIAL IN THE CUSTODY OF CONTRACTORS

BY CONTRACT PURPOSE OR TYPE



On Hand
SEP 30, 1987
(In Millions of Dollars at Acquisition Cost)

	GFM [1]	CAM [2]	TMAT [3]
R D T & E	971.3	670.5	1,641.8
SUPPLIES & EQUIPMENT	7,232.7	1,480.7	8,713.4
FACILITIES CONTRACT	121.7	94.7	216.4
LEASES	1.7	0.0	1.7
MAINTENANCE & REPAIR	1,900.8	294.6	2,195.4
OPERATION OF GOCOs	598.9	369.9	968.8
SERVICE CONTRACTS	990.7	200.3	1,191.0
STORAGE	25.8	11.5	37.3
OTHERS	546.8	115.4	662.2
TOTAL	12,390.4	3,237.6	15,628.0

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[1] GFM is government material furnished from either (1) government inventory, (2) other DoD contractors producing components or assemblies to be incorporated by the receiving contractor into the end product, or (3) the instant contractor in the form of a transfer from another contract.

[2] CAM is government material which is acquired directly from non-government sources by the contractor under the cost provisions of its contract.

[3] TMAT is Government Material as a total of GFM and CAM.

THE SECRETARY OF DEFENSE
WASHINGTON THE DISTRICT OF COLUMBIA

23 JAN 1987

Honorable Jamie L. Whitten
Chairman, Committee on Appropriations
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Your Committee's August 14, 1986, Report (99-793) contains a section regarding Government Furnished Equipment and requests a report on DoD improvements.

Recent studies by the General Accounting Office (GAO), DoD Inspector General (DODIG) and my staff continue to show that government-owned property in the possession of contractors has been increasing and past efforts to phase-down government ownership have not been fully successful. Our detailed review that began last spring determined that strong measures were necessary to bring about major improvements in this area.

I am pleased to report that we have established a strong program to address the acquisition, management, control and disposal of government property in the possession of contractors. The comprehensive policy direction issued by the Under Secretary of Defense for Acquisition on November 25, 1986, is attached for your information and as a report of our progress. This policy directs the disposal of old, obsolete and non-essential government property. It further states that the Military Departments and Defense Agencies must stop the continuing increase in new property going to contractors. You will note that the attached policy specifically addresses various GAO and DODIG findings and recommendations.

As appropriate, this new Defense policy will be codified in DoD issuances and the Federal Acquisition Regulation during the next year. We will be tracking the Departments' and Agencies' improvements on a regular basis.

Thank you for your interest in this area of Defense management.

Sincerely,

Caspar W. Weinberger

Attachment

THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301

ACQUISITION

[illegible] 1986

A&L(PS)

MEMORANDUM FOR THE SECRETARIES OF THE MILITARY DEPARTMENTS
DIRECTORS, DEFENSE AGENCIES
PRESIDENT, UNIFORMED SERVICES UNIVERSITY OF HEALTH SCIENCES

SUBJECT: Government Property in the Possession of Defense Contractors

Recent studies by the General Accounting Office (GAO), DoD Inspector General, and this office continue to show that government-owned property in the possession of contractors has been increasing and our past efforts to phase-down government ownership has not been fully successful. The reviews also concluded that millions of dollars are being needlessly expended annually by not disposing of excess or otherwise non-essential property. In most cases these problems would not exist if current DoD policies relating to the acquisition, management, control and disposal of government property were being followed.

Departments and Agencies of the Department of Defense (DoD) must dispose of the old, obsolete and non-essential government property including that which we have in storage, reduce the amount of property in the possession of contractors, and bring to a halt the continuing increase in new property going to contractors. Actions that need to be taken range from your placing more discipline into the implementation of existing policies, to revising the Federal Acquisition Regulation. To begin these actions, the attachment includes direction that is effective immediately. We are required to track improvements on a regular basis through various forums, including the Defense Council on Integrity and Management Improvement (DCIMI), as appropriate.

Some of the policy guidance included in the attachment may require the reprogramming of funds. This should not deter your actions since potential savings will more than offset the expense.

The lead responsibility for DoD property policy and management is assigned to the Assistant Secretary of Defense (Acquisition and Logistics) (ASD(A&L)). In this capacity the ASD(A&L) shall take whatever additional actions are required to revise or issue new policy directives. Assistance from your personnel to accomplish these actions will be needed, and your early designation of the appropriate people will expedite the issuance of new or revised policies.

I would appreciate your support in implementing these property improvements as a priority effort.

Attachment

Copy to:
DOD/IG

INDUSTRIAL FACILITIES
(REAL PROPERTY, INDUSTRIAL PLANT EQUIPMENT AND OTHER PLANT EQUIPMENT)
(FAR 45.302)

o The new procurement of industrial facilities with defense funds for use by contractors must be drastically limited if we are to reduce government-ownership. Providing existing government property to contractors must also be limited. This property shall be financed by the private sector except under highly unusual circumstances. Part 45.302 of the Federal Acquisition Regulation (FAR) sets forth exceptions when facilities may be provided.

o The contracting activities' implementation of FAR exceptions have become too loose and are permitting the furnishing of large amounts of general purpose equipment that should be privately financed.

o All DoD components must exercise more discipline in carrying out the existing policies not to provide government-owned facilities to defense contractors.

o One of the FAR exceptions for providing industrial facilities relates to a contractor's inability or unwillingness to provide such facilities. This by itself is not a sufficient reason to expend defense funds to acquire government-owned industrial facilities. Appropriate defense officials and not a contractor must determine and certify the need for government-ownership. The contractor's statement asserting inability or unwillingness to obtain the facilities standing alone will not be used as the basis for providing government-owned industrial facilities. The FAR should be revised to make this clear.

o A certification in addition to normal detailed justification must be completed if government-owned industrial facilities are to be provided to any defense contractor. As part of the facilities project approval document, the government approving officials and program/project managers shall certify:

1. That private financing of the industrial facilities was sought but was not available or that private financing was determined not advantageous to the government, and

2. That the Defense contract cannot be accomplished without government-owned industrial facilities being provided.

The original of the certification shall be included in the contract file and copies retained in a central office for oversight review.

INCENTIVES FOR CONTRACTOR INVESTMENT

o All procuring activities should be advised to use available contracting incentives to encourage greater contractor investment in productivity enhancing manufacturing equipment. This includes DoD Directive 5000.44, "Industrial Modernization Incentives Program (IMIP)," and the capital investment incentives that will be published in the Federal Acquisition Regulation in the near future.

SPECIAL TOOLING/SPECIAL TEST EQUIPMENT (ST/STE)
(FAR 45.306 and 45.307)

o GAO data reflect that Special Test Equipment (STE) in the possession of contractors is increasing. The DODIG has found waste in the excessive storage and lack of disposal of Special Tooling (ST).

o DoD components shall promptly dispose of unneeded ST/STE from contractors locations or government storage and shall modify storage agreements. See further policy in section entitled "Control/Limit Storage of Property."

o The overall acquisition, management, and disposition of government-owned special tooling (ST) must be improved.

o DoD components' procedures must be strengthened to ensure that other plant equipment (OPE) is not procured or misclassified as ST or STE.

MATERIAL
(FAR 45.303)

o This class of government property accounts for the single largest dollar amount of property in the possession of contractors. Management problems in this area have been identified. Priority attention is required to ensure that all systemic problems are corrected. This action relates to an effort resulting from DoDIG Case 84-032. In addition, DoD components should fully implement DODI 4140.48 to control the access to DoD material inventories by defense contractors.

o Where unauthorized access by contractors into the DoD supply system to obtain government furnished material (GFM) is found, all appropriate action, including investigation of possible criminal violations, should be initiated. In addition, such situations indicate a breakdown of internal controls and, as such, must be reported in the DoD components' annual certifications required by the Federal Managers' Financial Integrity Act relating to internal controls.

PROPERTY ROLLOVERS/TRANSFERS
(ALL CLASSES OF PROPERTY)

o Reviews have determined that property is being rolled over/transferred from contract-to-contract without proper approval and without identifying that the government has received adequate consideration for the continued use by the contractor. Government-property that is provided to a contractor is for the performance of a particular contract with adequate consideration obtained under that contract for such use. Property is not to continue to remain in a contractor's possession beyond the period of original authorization without new approvals.

o Government-property provided to perform a defense contract shall be removed from the plant when the property is no longer required for contract performance but not later than when the contract is complete. It shall not be transferred to another contract unless an approval for retention is obtained and the government receives adequate consideration.

PROVIDING PROPERTY TO SERVICE CONTRACTORS

o Service contracts have accounted for a high percentage in the growth of government-owned property in the possession of contractors. A portion of this growth appears to be due to the growth of A-76 programs. Service-type contracts range from commercial type activities (A-76) at military installations to service contractors operating GOCO plants to produce defense products.

o The basic policy that government property will normally not be provided applies in this case as well as others. However, certain exceptions such as commercial activities use of existing property and others need further clarification. The policy for providing property to service contractors until more definitive guidelines are developed is to be in accordance with the FAR and this memorandum.

o Within three months DoD components should provide the ASD(A&L) recommendations for the development of more specific guidelines for providing existing government property to service contractors performing commercial or industrial type activities.

CONTROL/LIMIT STORAGE OF PROPERTY

o The storage of unneeded ST and STE on so called "no cost" (actually no direct cost) storage agreements for extended periods of time is costing millions of dollars annually in overhead charges. DoD components shall: 1) cease using no-cost storage agreements; 2) require justification for continued storage and establish procedures for annual screening for retention/disposition; 3) all storage agreements shall be separately priced and directly funded, and; 4) dispose of all excess ST and STE on an expedited basis.

o The continued storage and maintenance of inactive plants, industrial plant equipment (IPE) and other plant equipment (OPE) shall to be reviewed in detail and all but the most essential property removed from the DoD inventory. All such inactive property should be included in this review and be considered a candidate for disposal unless retention is fully justified. Examples of property to be included in this review include:

- All IPE in the DIPEC General Reserve. Only essential equipment in a ready-to-issue condition shall be retained.

- All inactive property (IPE, OPE, ST and STE) in plant equipment packages (PEPs). This includes contractor owned property that DoD is funding to retain in storage. Plans must be established for reducing PEPs to the very minimum by November 1988. Retained PEPs must be upgraded to an immediate use condition within current budget constraints. PEPs should not be upgraded unless a viable method also exists to assess their continuing state of readiness. PEPs without a planned producer for more than one year should be immediately discontinued. No new PEPs should be established until these improvements are completed.

- Inactive GOCO plants - The continued retention of these plants results in the expenditure of valuable resources. A priority for retention needs to be assigned to each plant. Plants having a marginal surge or mobilization potential should be turned over to the private sector.

o Within three months brief the ASD(A&L) regarding costs being incurred to store/retain each class of inactive property, action plans for disposal, and plans for continued retention with justification and annual costs.

DISPOSAL/RETENTION OF PROPERTY

o Untimely dispositions of excess property - The GAO recently found that some contractor and defense officials are not taking timely actions to dispose of property declared excess to government needs. Contract administration and contracting activities, must take immediate actions to review all contracts with government property and dispose of all unneeded/excess property.

o Identify plants and equipment that are considered essential for government ownership to accomplish your mission. The Defense Industrial Reserve Act of 1973 permits DoD to maintain an essential nucleus of plants and equipment to support national emergencies. Property in excess of this essential nucleus should not be retained. Each DoD component shall identify essential facilities (plant and equipment) proposed for retention and develop a time-phased action plan for disposing of non-essential facilities. Government-owned contractor-operated (GOCO) plants and related equipment as well as all other equipment are to be included. This information should be included in a briefing to the ASD(A&L) within three months. If your agency has relatively few industrial facilities, your written action plan should be furnished to the ASD(A&L). The essentiality, priority and impact data for GOCOs will continue to be submitted annually as part of the Defense Industrial Plant Reserve Report required by DODI 4155.4. Internal records and controls should be maintained for equipment not associated with GOCO plants.

o DoD components shall identify those Government-owned contractor operated facilities where continued ownership by the Department of Defense is no longer essential. Where the facilities are essential for the operating contractors to continue performance of DoD programs, these facilities shall be candidates for negotiated sale by GSA to the operating contractors. Such sales would be pursuant to the Federal Property and Administrative Services Act of 1949, as amended, where consistent with the opinion of the Department of Defense General Counsel dated November 19, 1970.

o The ASD(A&L) shall prepare legislation for inclusion in the 1987 legislative program of the Department of Defense to provide authority for negotiated sale for DoD-owned industrial property where authority for such sale does not now exist as set forth in the DoD General Counsel opinion of November 19, 1970.

GENERAL MANAGEMENT AREAS

o Unallowable profit/fee - The GAO and DoDIG have found examples where contractors have received a profit when acquiring equipment for the government's account. Industrial facilities are normally to be provided on a cost reimbursable no-fee facilities contract. The FAR policy of providing facilities on a no-fee facilities contract must be followed by DoD components. All DoD components will identify any profits or fees that have been paid to contractors on a facilities contract. The DoD components will also identify general purpose plant equipment that has been acquired by contractors on other than a facilities contract and determine if such equipment should have been furnished under a no-fee facilities contract. Action should be taken to recover any improper profits or fees on open contracts whenever this can be accomplished legally.

o Financial Accounting System - The establishment of Financial Accounting Systems for government-owned property shall be fully implemented in accordance with the individual milestones established for each DoD component by the ASD Comptroller but no later than October 1989. Your personal attention may be necessary to insure the milestones for meeting these dates are accomplished. Congress has been informed of the specific dates that the Services and DLA will implement their financial accounting systems for Government property.

o DoD Property Accountability Report (DD FORM 1662) - DoD components shall take all necessary actions to ensure that the revised FAR 45.505-14 industrial property report is fully operational by October 1987. This will require the application of necessary personnel and computer resources. This revised information system will provide accountability data that are not currently available, will complement the financial accounting system and shall be used by all DoD components to assist in the enforcement of defense property policies.

o Personnel - The performance appraisal agreements of personnel having significant property management responsibilities shall include appropriate evaluation standards. It appears that the property function has been given a relatively low priority for personnel resources. The DoD components are directed to realign existing resources as necessary to provide for adequate staffing. In addition, property personnel should be provided training to enhance their management and technical skills. Within three months the ASD(A&L) should be advised of your current and projected staffing levels for managing defense-owned government property in the possession of contractors. This should include the designation of a focal point within your office that has overall management responsibility for government property in the possession of contractors.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

PRODUCTION AND
LOGISTICS

JUN 25 1987

PS/IR

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (RESEARCH DEVELOPMENT AND ACQUISITION)
ASSISTANT SECRETARY OF THE NAVY (SHIPBUILDING AND LOGISTICS)
ASSISTANT SECRETARY OF THE AIR FORCE (ACQUISITION)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Defense Government Property Initiatives

On March 27th, you briefed plans to implement the policy in USD(A) memorandum of November 25, 1986, "Government Property in the Possession of Contractors." Thank you for those briefings. Your plans must now be worked aggressively in order to show positive results. Secretary Weinberger has committed to Congress the USD(A) policy as the Defense Initiative for improving the management of government property in the possession of contractors.

As stated in Mr. Godwin's memorandum, we are required to track improvements on a regular basis through various forums, including the Defense Council on Integrity and Management Improvement (DCIMI). The first meeting with the DCIMI regarding this property initiative is scheduled for October.

We request you review your implementation plans to assure the completion of each task within the USD(A) memorandum. Attached, for this purpose, is a "Government Property Initiative Chart" that will be used for reporting the status of these tasks to Mr. Godwin, the DCIMI, the DoD/IG, and Congress.

Your first submission should be as of June 30, and arrive in this office within 45 days, but not later than August 17. Future updates shall be furnished within 45 days after the close of each calendar quarter.

Finally, we need to establish a baseline against which progress in property management, over the long haul, can be measured. The Defense Government Property Council should establish the specific items to be measured.

Robert B. Costello
Assistant Secretary of Defense
(Production and Logistics)

Attachments

Copy to: DoD/IG

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301-8000

JUN 25 1987

PRODUCTION AND
LOGISTICS
PS/IR

MEMORANDUM FOR DIRECTORS OF DEFENSE AGENCIES

SUBJECT: Defense Government Property Initiatives

On March 27th, the Services/DLA briefed my office and the DODIG on plans to implement the USD(A) memorandum of November 25, 1986, which stated DoD's property policies, copy attached. Secretary Weinberger has committed to Congress the USD(A) policy as the Defense Initiative for improving the management of government property in the possession of contractors. These policies must now be aggressively implemented in order to show positive results.

As stated in Mr. Godwin's memorandum, we are required to track improvements on a regular basis through various forums, including the Defense Council on Integrity and Management Improvement (DCIMI). The first meeting with the DCIMI regarding this property initiative is scheduled for October.

We request you review your implementation plans to assure the completion of each task within the USD(A) memorandum. Enclosed for this purpose is a "Government Property Initiatives Chart" that will be used for reporting the status of these tasks to Mr. Godwin, the DCIMI, the DODIG, and Congress.

Your first submission should be as of June 30, and arrive in this office within 45 days, but not later than August 17, 1987. Future updates shall be furnished within 45 days after the close of each calendar quarter.

Finally, we need to establish a baseline against which progress in property management, over the long haul, can be measured. The Defense Government Property Council will establish the specific items to be measured. Your inputs to the Deputy Assistant Secretary of Defense for Production Support, Room 3E144, Pentagon, are requested for consideration.

Please contact Mr. James H. Kordes, Office of the Assistant Secretary of Defense (Production & Logistics), 695-0292, if you require further information.

Robert B. Costello

Attachments
Copy to: DoD/IG

GOVERNMENT PROPERTY INITIATIVES CHART

Status Report Date: ____________________

Actions to Improve the Management of Government Property in the Custody of Contractors (USD(A) Memorandum, Nov. 25, 1986)

Task	Date Started	Target Comp. Date	Status at Reporting Date	Action Officer Name Symbol/Telephone
1. Ensure compliance with existing policies.				
2. Establish mechanism to track implementation of USD(A) memorandum of Nov. 25, 1986.				
3. Establish discipline in not providing facilities.				
4. Create procedure to certify need for facilities.				
5. Eliminate FAR exception: unwillingness to provide facilities.				
6. Increase use of incentives for contractor investment.				
7. Dispose of unneeded ST and STE; justify continued storage; review annually for disposal.				
8. Eliminate "no cost" storage agreements.				
9. Improve the acquisition, management and disposal of ST (DAR Case 85-241).				
10. Stop misclassification of plant equipment as ST or STE.				
11. Complete actions under DoD IG Report 84-032.				
12. Complete full implementation of DoDI 4140.48; stop unauthorized access to DoD supply system for GFM.				
13. Establish formal process for assessing risks & possible criminal violations in GFM areas; report results under Federal Managers' Financial Integrity Act requirements.				
14. Limit property transfers between contracts and receive adequate consideration; do not transfer without specific authority.				

GOV NMENT PROPERTY INITIATIVES CHART
(Continued)

Task	Date Started	Target Comp. Date	Status at Reporting Date	Action Officer Name Symbol/Telephone
15. Provide OASD(P&L) recommendations for service contract property policy.				
16. Eliminate storage & maintenance of inactive, non-essential GoCos and equipment not in GoCos.				
17. Track & report storage & maintenance costs and retention priority on all inactive GoCos.				
18. Eliminate storage & maintenance of non-essential General Reserve IPE.				
19. Bring General Reserve IPE into ready-for-issue condition.				
20. Eliminate storage & maintenance of non-essential PEPs.				
21. Track & report storage & maintenance costs on all inactive equipment in PEPs.				
22. Review each property-bearing contract; dispose of property not required.				
23. Identify mission-essential govt plants and equipment; dispose of non-essential in time-phased plan.				
24. Sell essential plants where ownership is not required; update OASD(P&L) on plans.				
25. Eliminate unallowable profits/fees; recover those paid on open contracts.				
26. Fully implement financial accounting.				
27. Complete property reporting via DD Form 1662				
28. Include standards for property management in managers' performance appraisals.				
29. Realign resources to staff property functions.				
30. Fully train property personnel & enhance their management & technical skills.				

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D C 20301-8000

PRODUCTION AND
LOGISTICS

PS/IR

29 JAN 1988

MEMORANDUM FOR ASSISTANT SECRETARY OF THE ARMY (RESEARCH, DEVELOPMENT & LOGISTICS)
ASSISTANT SECRETARY OF THE NAVY (SHIPBUILDING & LOGISTICS)
ASSISTANT SECRETARY OF THE AIR FORCE, (ACQUISITION)
DEFENSE LOGISTICS AGENCY

SUBJECT: Property Data Required for the House Appropriations Committee (HAC)

The SecDef furnished the USD(A) property policy direction to the HAC in January 1987, as the Department of Defense (DoD) program for improving property management. The Committee had GAO review this DoD property initiative. The GAO found that while the initial policy to bring about improvements had been issued, full implementation is estimated to be as far off as 1992. The GAO particularly noted a slow effort in recouping improper profits and stated that some DoD activities are not aware of the USD(A) policy because they have not received it.

The 1988 HAC Report (100-410) directs the DoD to: (1) ensure full dissemination of property policy, (2) accelerate recoupment of improper profits, and (3) report the status of actions and achievements to the Committee by February 1, 1988. We have provided an interim reply and advised the Committee that they will receive a full report by April 1988. To complete this report and be responsive to the Appropriations Committee, we require specific information no later than March 15. We wish to show the Committee quantifiable achievements wherever possible. Attachment 1 is a format for presenting this type of information.

We will use the data you provide in response to the quarterly progress report established by ASD(P&L) memorandum of June 25, 1987, to the maximum extent possible. However, in some cases the data presented in quarterly reports or at the initial briefings to the ASD and DoDIG have not been complete or quantifiable. Please review the current target completion dates and develop expedited implementation milestones for areas that are not targeted for completion during 1988. These milestone charts should accompany future quarterly reports. Particular emphasis needs to be given to accelerating the recoupment of identified improper profits and reviewing open contracts for other unallowable profits relating to facilities acquisition.

The Army's quarterly report has been showing that an acquisition letter is being staffed to implement the USD(A) property policy. Please provide us reasons for the delay, milestones for completion, and copies of any implementing memoranda or regulations.

These issues will be presented to the DoD Council on Integrity and Management Improvement (DCIMI) on February 19. Please refer any questions regarding this data requirement to Mr. Jim Kordes, 695-0292.

Jack Katzen
Deputy Assistant Secretary of Defense
(Systems)

Attachment

ACTIONS AND ACHIEVEMENTS

DATA RELATING TO THE IMPLEMENTATION OF USD(A) PROPERTY POLICY MEMORANDUM OF NOVEMBER 25, 1986 -- FOR HAC REPORT 100-410

UNALLOWABLE PROFITS/FEES

o DoDIG/Service identified as unallowable - $________

-- Amount recouped as of January 1, 1988 - $________

-- Attach milestone schedule for recouping remainder.

o Facilities provided under other than a facilities contract

-- Number of contracts to be reviewed - ________

-- Number reviewed as of January 1, 1988 - ________
---Identified unallowable profit - $________

-- Attach milestone schedule for reviewing remainder of contracts

DISPOSAL of EXCESS/SURPLUS/INACTIVE/NON-ESSENTIAL PROPERTY

o Eliminate "NO COST" Storage Agreements
-- Agreements eliminated as of January 1, 1988 ______
- ST/STE disposed of Amt:____ $________
(include if separately identified from total disposals)

-- Number of open agreements as of 1/1/88 ____________

o Review contracts and dispose of unneeded/excess property
-- Number of contracts reviewed as of January 1,1988 _______

-- Property (by class) disposed- Amt.______ $_______

-- Remainder of contracts to be reviewed - Amt.______

o Plant equipment packages (PEPs)
-- As of 1/1/87 -(by property class)- Amt.______ $______

-- As of 1/1/88 -(by property class)- Amt.______ $______

o Government-owned Contractor-operated (GOCO) plants

-- Candidates for disposal during 1988/1989 - Amt.______

IMPLEMENTING POLICY MEMORANDA, REGULATIONS, FAR SUPPLEMENTS

o Quantity of documents issued as of January 1, 1988

-- Number_______ Subject areas_________

OTHER ACTION AND ACHIEVEMENT DATA

o Other facts the Services/DLA have available for this Report

RESPONSES OF ROBERT B. COSTELLO TO WRITTEN QUESTIONS SUBMITTED BY SENATOR GLENN

QUESTION: It appears that DoD has created a separate supply system of large magnitude in the hands of contractors. This separate system has more serious problems with accountability and control than those which exist in DoD's internal supply system. DoD is unsure of how large it is, what it consists of, and how much of it is excess to its needs. Do you agree with this description? What major obstacles continue to stand in the way of adequately managing this inventory?

ANSWER: We do not agree with that description. Government property in the hands of contractors is there not because of a separate supply system but because of the nature of contracting. We contract directly for components of weapon systems, such as jet engines, and furnish them to prime contractors. These jet engines, etc. are reported as GFM. The Spare Parts Break-out Program has additionally resulted in more reported GFM since DoD contracts directly with the subcontractor/vendor. This type of contracting is done to reduce overhead costs, to standardize specifications, and to broaden the industrial base. Likewise, we own ammunition plants and missile tracking systems that are operated by private firms. All of these are part of government property in the possession of contractors that is included on our report. We do know how much property we have and what it consists of. As of September 30, 1987, $51.3 billion was reported in our new system. We are aware that there was under reporting because of the newness of the reporting system. The contractual requirement to report all property had not been included in all contracts as of the last reporting date. There are no major obstacles standing in the way of improved property management. The DoD Components are continuing to implement the Under Secretary of Defense for Acquisition [USD(A)] property policies that were issued November 25, 1986. There may be a shortage of fully trained property administrators and plant clearance officers to do the kind of in-depth management oversight we would like to do. However, this is a focus of Service and Defense Logistics Agency improvements, as a result of USD(A) property policy direction.

QUESTION: During the hearing, GAO commented on the adequacy of DoD's new reporting system for the cost of DoD property in the hands of contractors. For one thing, it seems that the figure of $51 billion is understated. What is your opinion on its accuracy? In addition, what is your opinion on the need for centralized reporting of gains and losses of government owned property and of excesses?

ANSWER: The GAO suggested it was understated because DoD told them it was. The reporting system was expanded in 1986 to include all categories of property, as well as quantities of most categories and dollar additions to and deletions from contracts. This expanded reporting system was not automatically implemented; it required contractual coverage or agreements to obtain the data without contractual coverage by the last reporting date. Therefore, there was a period when all contractors holding government property were not included in the report. They all will be reporting when their contracts are updated or renewed. The accuracy of this new reporting system will increase, as the system matures and reporting is complete. DoD instituted the reporting of additions and deletions of property when the expended DD Form 1662 reporting system was established. The DoDIG has found that this mechanism adds a positive degree of accountability to the report that did not exist before. In some cases, this was not practicable, for example, in the category of government material (as opposed to plant equipment or special tooling or special test equipment). For the material category, unlike items of various quantities are being added or deleted (sometimes daily or hourly), so a summary of additions and deletions in an annual report is of little meaning and costly. For over twenty years, DoD has had summarized reports to departmental headquarters regarding property that has been declared excess to the requirements of contracts (DD Forms 1638, Report of Excess and Surplus Contractor Inventory). The details of reported excesses are available at individual plant locations.

QUESTION: Often DoD gives contractors what amounts to a credit card whereby they are given direct access to the DoD supply system. GAO indicates that control over the contractors is lax and that contractors can order almost anything they want from the supply system. Further, GAO indicates that the Management Control Activities (MCA) program to fix this problem is not working because the Services have ignored this program. What can be done to correct this problem?

ANSWER: Contractors are not allowed to order almost anything they want from the supply system. They are allowed to order from the DoD supply system if their contract specifies that government furnished material (GFM) will be provided under the contract. When GFM is authorized, the contractor is not paid as much as he would have been had GFM not been authorized. Also, when GFM is authorized, provisions of the contract specify that the contractor must maintain an inventory record of all GFM in accordance with DoD-specified guidelines. If a contractor orders material from the DoD supply system which is not needed for his contract or if he fails to maintain a complete inventory record of the GFM in his possession, he is in violation of his contract. Our basic assumption in this process is that our contractors perform in accordance with the provisions of their contracts. Additional controls which we apply to this process, such as contract administration officers, property control officers, and contractor requisition controls (including the use of Management Control Activities) are supplements to this basic, and we believe, valid, assumption. Although there have been difficulties in completing the implementation of the total (and now, revised) process of controlling contractor access to the supply system through automated requisitioning, the process should be implemented in 1989. My staff is currently working with the Services to assure that this implementation date is met.

QUESTION: Apparently there is a widely held belief by the operational people in DoD - those who contract for the building of new weapons and for the operation and maintenance of those weapons and of base facilities - that it is inherently less costly for the government to supply what a contractor needs rather than having him buy it. Do you agree with this belief? Are there factors other than cost that need to be considered? If so, what are they?

ANSWER: During fiscal year (FY) 1987, in excess of 450,000 contracts were administered by DoD contract administration offices. Only 19,700 of these contracts contained government-owned property. These numbers do not appear to support the contention that operational people prefer government-ownership of property. In some cases we agree that there can be cost benefits associated with providing government property. As an example, congressional committees, GAO, and others have long advocated that DoD pursue a weapon system component break-out program. We have increasingly purchased parts or components from vendors other than the prime weapon system contractor and then furnished it to the final assembly prime contractor as government-furnished material. Providing the components as GFM saves us money, and broadens our industrial base. Providing certain kinds of plant equipment and buildings ensures continued capability when demand is temporarily short and allows us to provide for production surges. Lethal munitions manufacturing facilities and missile tracking facilities, operated by contractors, are owned by the DoD because of specific mission requirements. A large part of the reported dollar value of property in the possession of contractors consists of a category called "agency-peculiar" property or "military property" by our use of the term. This amounts to entire weapon systems or components of weapon systems that have been provided to a contractor for test, evaluation, modification, repair, and the like--whole airplanes or tanks, if you will. We wish to emphasize that the basic DoD policy is that contractors will, to the maximum extent possible, provide the production facilities necessary to support defense production.

QUESTION: Many audit reports point out weaknesses in administration of government furnished property. What has caused the breakdown in property administration and what are you going to do about it? Are there not enough people in the function? Are they inadequately trained? Are they too low in grade?

ANSWER: We do not agree that there has been a breakdown in property administration. There is always a need for improvement, however, to categorize as a "breakdown" is inaccurate and misleading. Property management has often been seen as a function which adds little value to the acquisition and maintenance of weapon systems. So when there are reductions in training and travel budgets and in other allocated resources as well as in absolute numbers of people assigned, it appears that the property function suffered. We have taken a number of actions to change this attitude. The Under Secretary of Defense for Acquisition property policy direction of November 1986 includes a specific section relating to property personnel and actions to be taken by DoD Components. The Air Force has had an intern program supporting this function; the Navy is instituting one. We have asked the DoD Components to reallocate resources where necessary to support this program and to improve training. We do know, in some specific instances, that property personnel are paid less than their industry counterparts, and often are hired by private firms after we have trained them.

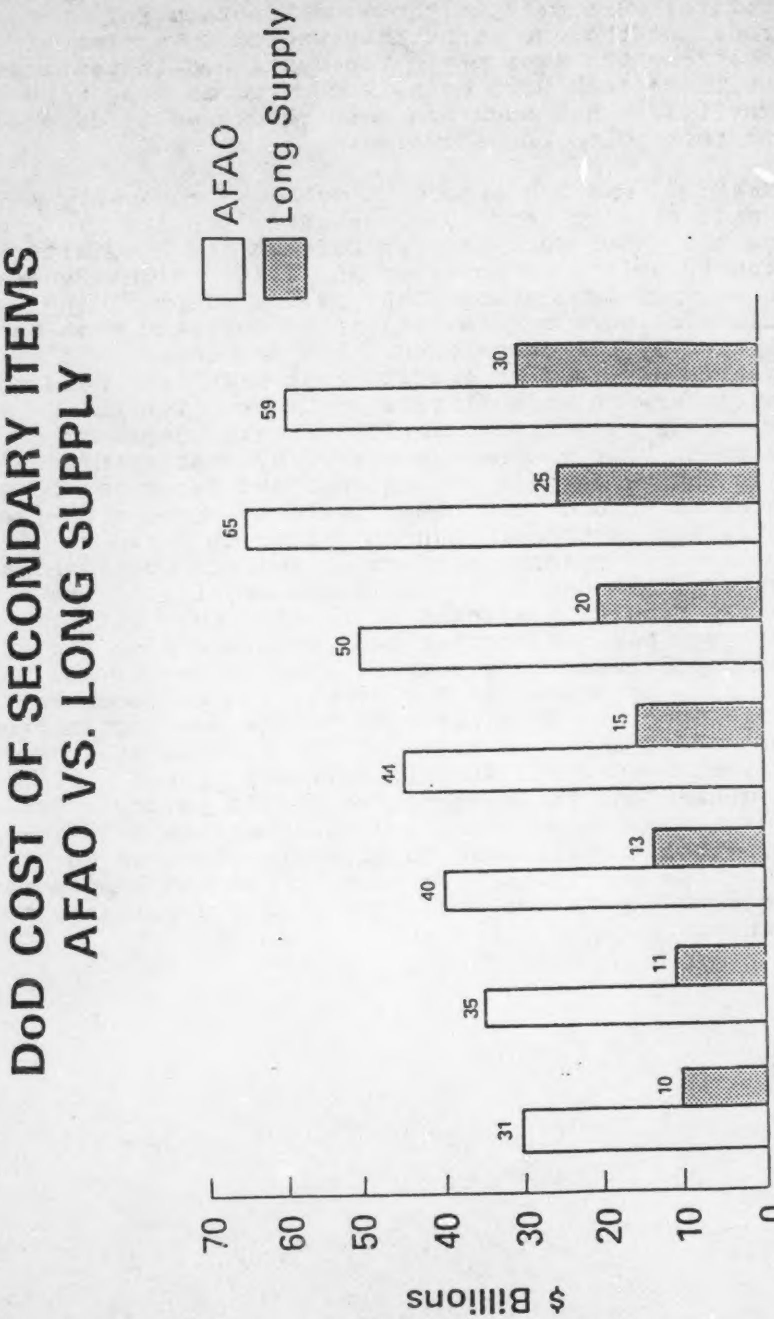
QUESTION: Throughout the DoD supply system - including DoD's extended supply system in the hands of contractors - there seems to be another prevailing belief. This belief is that the penalty for a supply person who is out of stock of needed items is far more severe than the rewards for keeping supplies to a minimum while still meeting operational needs. Is this true? What kind of problem does this create for government furnished property?

ANSWER: First of all, we do not believe the issue here is penalties for supply people nor is it correct to say that DoD has an "extended supply system in the hands of contractors." Since World War II, the rapid evolution of modern technological weapons has required the close cooperation of the DoD and American industry. The necessity for positioning GFM and other government-owned property at contractor locations is but one aspect of this evolutionary process. It is, however, correct to say that our highest priority in the supply process is assuring that all necessary supplies are available when needed by the operating forces. The business processes which support this essential tenant must always put this readiness requirement first. Because of the cost of contemporary weaponry, support systems and materials, these business systems must be as efficient as possible within this "readiness first" context. This system of priorities does present challenges which would not otherwise be present if business efficiency were the only priority. It is indeed the goal of the supply system to keep supplies to a minimum while still meeting operational needs. The DoD will continue to initiate and implement programs to improve the efficiency of our processes. The recent implementation of our reporting system for government property in the possession of contractors and our continued efforts to implement DoD-wide procedures for controlling contractor access to the DoD supply system at the individual line item level offer evidence not of system problems but rather of the Department's concerted efforts to operate a completely responsive supply process at optimum efficiency.

QUESTION: With respect to the DoDIG's audit of consulting contractors in the Washington area, fees (profits) were paid to those contractors for purchasing the equipment they wanted. Payment of these fees was improper. You mentioned in testimony that those fees were being recovered as they were identified. How much has been recovered to date? How much remains to be recovered.

ANSWER: The DoD effort to collect improperly paid fees is broader than this one audit report. To quote from the Under Secretary of Defense for Acquisition property policy of November 25, 1986 - " The Federal Acquisition Regulation (FAR) policy of providing facilities on a no-fee facilities contract must be followed by DoD components. All DoD components will identify any fees or profits that have been paid to contractors on a facilities contract. The DoD components will also identify general purpose equipment that has been acquired by contractors on other than a facilities contract and determine if such equipment should have been furnished under a no-fee facilities contract. Action should be taken to recover any improper profits or fees on open contracts whenever this can be accomplished legally." The lastest figures available to us show that $84,627 had been recouped and another $203,000 scheduled for recoupment later this summer. The review of all contracts is scheduled for completion in December 1989. Specific data relating to the Washington Area DoDIG audit that was released May 6, 1988 will be obtained by the DoDIG audit followup system. It is noted that the existing no-fee profit policy relating to general purpose plant and equipment is only specifically applicable to property acquired on facilities contracts. We have introduced a proposed change to the FAR to make this policy applicable to contracts.

CHART 1

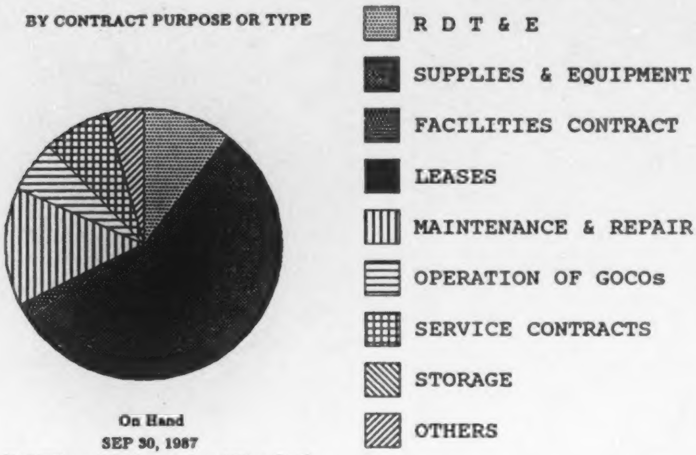


DoD COST OF SECONDARY ITEMS AFAO VS. LONG SUPPLY

CHART 2

GOVERNMENT MATERIAL IN THE CUSTODY OF CONTRACTORS

BY CONTRACT PURPOSE OR TYPE



On Hand
SEP 30, 1987
(In Millions of Dollars at Acquisition Cost)

	GFM [1]	CAM [2]	TMAT [3]
R D T & E	971.3	670.5	1,641.8
SUPPLIES & EQUIPMENT	7,232.7	1,480.7	8,713.4
FACILITIES CONTRACT	121.7	94.7	216.4
LEASES	1.7	0.0	1.7
MAINTENANCE & REPAIR	1,900.8	294.6	2,195.4
OPERATION OF GOCOs	598.9	369.9	968.8
SERVICE CONTRACTS	990.7	200.3	1,191.0
STORAGE	25.8	11.5	37.3
OTHERS	546.8	115.4	662.2
TOTAL	12,390.4	3,237.6	15,628.0

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[1] GFM is government material furnished from either (1) government inventory, (2) other DoD contractors producing DoD contractors producing components or assemblies to be incorporated by the receiving contractor into the end product, or (3) the instant contractor in the form of a transfer from another contract.

[2] CAM is government material which is acquired directly from non-government sources by the contractor under the cost provisions of its contract.

[3] TMAT is Government Material as a total of GFM and CAM.